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FINANCIAL MANAGEMENT PROBLEMS IN THE U.S. AIR FORCE

HEARING

BEFORE THE

COMMITTEE ON GOVERNMENTAL AFFAIRS UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

SECOND SESSION

FEBRUARY 23, 1990

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CONTENTS

Opening statements: Page

Senator Glenn 1
Senator Cohen 6
Senator Lieberman 7

WITNESSES

FRIDAY, FEBRUARY 23, 1990

Charles A. Bowsher, Comptroller General, U.S. General Accounting Office, accompanied by Donald H. Chapin, Assistant Comptroller General for Accounting and Financial Management, Frank Conahan, Assistant Comptroller General for National Security and International Affairs, and Terry Carnahan, Assistant Director, Accounting and Financial Management Division 9

APPENDIX

Prepared statement of Charles A. Bowsher, Comptroller General, U.S. General Accounting Office 45
"Financial Audit: Air Force Does Not Effectively Account for Billions of Dollars of Resources," GAO report, February 1990 61
Letter to Charles A. Bowsher from Donald B. Rice, Secretary of the Air Force, February 15, 1990 170

FINANCIAL MANAGEMENT PROBLEMS IN THE U.S. AIR FORCE

FRIDAY, FEBRUARY 23, 1990

U.S. SENATE,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, DC.

The Committee met, pursuant to notice, at 9:36 a.m., in room 342, Dirksen Senate Office Building, Hon. John Glenn, Chairman of the Committee, presiding.

Present: Senators Glenn, Levin, Sasser, Cohen, and Lieberman.

OPENING STATEMENT OF CHAIRMAN GLENN

Chairman GLENN. The hearing will be in order. The Governmental Affairs Committee is charged with, among other things, looking at efficiencies in Government. One of the areas we have gotten into extensively in past years have been the Defense Department's contracting procedures. There are efficiencies to be achieved there, but, a key question is, can we rely upon their information? Can we make improvements?

This morning the Governmental Affairs Committee meets to examine a wide ranging financial management audit of the United States Air Force. The General Accounting Office selected the Air Force for its first comprehensive financial management review, and that is rather shocking, because it is the only military service that has attempted to develop a set of financial statements in accordance with generally accepted accounting principles for Federal agencies.

This hearing was originally scheduled for March, but the leak of the draft GAO report to the Washington Post, among others, caused us to alter our schedule. The Comptroller General may want to address what happened in that particular regard with his statement.

The Air Force has resources valued at about $275 billion and receives almost $90 billion in annual appropriations. It operates 130 bases located throughout the world, representing about 16 percent of all the real property held by the U.S. Government. The Air Force manages a reported $99.1 billion of weapons systems—aircraft, missiles, and engines—and a reported $63.8 billion of inventories of supplies and spare parts, which amounts to about 20 percent of the equipment and almost 30 percent of the inventories held by the U.S. Government. The Air Force employs about 900,000 civilian and military personnel.

This audit is historic since it is the first time such a comprehensive effort has ever been undertaken. I understand it required approximately 25,000 days of GAO audit time and undoubtedly a comparable thousands of hours of time from the Air Force. According to Comptroller General Bowsher's report, the Air Force's financial management systems and internal controls are "not sufficient to provide adequate and reliable financial information for effective management of the Air Force's diverse and complex operations." What does it really mean to members of the Senate or the public if the Air Force's accounts are "unauditable," and are "inaccurate or unreliable"?

First, it means that Congress may be presented with and make major decisions to procure weapons systems where the true cost of already procured weapons is unknown and where there is a consistent pattern of understating such cost. For example, the Air Force claims the cost of a single B-1-B bomber is $150 million. GAO believes such "flyaway" costs are incorrect because they fail to account for other items necessary to bring the aircraft up to mission capability, and that the true cost of a B-1-B is $219 million. Such a difference in costs results in a staggering difference of "financial opinions: did the B-1-B program cost $21.9 billion which the Air Force claims, or an additional $7.1 billion? Similarly, GAO believes the cost of the F-15 program is understated by $6.8 million, and the F-16 by $6.3 billion. That is big money, real money, and it really shows that with more accurate information, major decisions to procure might change based on the cost differences.

If the reported costs of military hardware are grossly understated and actual costs cannot be determined, it confirms we cannot make the best decisions with the taxpayers' money. The Air Force believes that the Selected Acquisition Reports, the so-called SAR, provided to Congress on major weapon systems, reflect those costs more accurately and the GAO's point in this regard is not well taken.

The fundamental questions facing the Congress is, if the financial information provided by DOD is as bad as the GAO report suggests, how can the Congress rely on the budget and other information which DOD provides it? Do we have to add a fudge factor to all of DOD's budget and cost estimates to account for the understatement of costs?

As an aside, many years ago I was in the Navy's Old Bureau of Aeronautics for a short time, I had a project desk on certain aircraft. And I know that when contractors with their past history of underbidding, put in a contract bid, we had a traditional fudge factor of 15 percent or 20 percent to account for the fact that they always understated things by that amount. Have we not made any progress since those days of 30 years ago when that was the way the Government did its business with regard to procuring aircraft or parts or whatever?

Second, the Air Force rightly measures its success on mission readiness—getting airplanes fueled, loaded with the bombs, and on the way to a target—and not whether its financial accounting systems are adequately tracking expenditures. But when financial accountability is lost and inaccurate cost information exists, then our ability to make sound choices with the taxpayers's money is lost.

When financial accountability is lost or inaccurate cost information exists, commanders of similar air wings or bases may achieve equivalent degrees of mission readiness by far different levels of efficiency and costs. And unfortunately, the lack of adequate data does not permit the Air Force the visibility to see much differences. As a practical matter, this means the Air Force is no more likely to promote the efficient wing commander or have his methods and techniques copied at a similar base, depot or command.

Third, in the absence of adequate financial management information and systems, it is equally clear that the Air Force has purchased $11 billion in spare parts for aircraft and systems that it appears will never be used, or could have been purchased at a significantly later time when the need for such items was more clearly defined. We are planning a hearing on this specific issue on March 6. I might add that this hearing gets into the long supply area that we have had several hearings on through the years. Long supply being items that are in stock for which there is no known use. As I recall the figures, long supply for the Department of Defense, as a total, went from $9 billion worth of material stored or stocked or whatever, for which there was no know use—$9 billion in 1980 up to, I believe, an estimated $31 billion by 1986.

Mr. BOWSHER. It is even a little higher than that right now, Mr. Chairman.

Chairman GLENN. From $9 billion to $31 billion does not show very good financial management or purchasing procedures. Even items that are on order fall into these excess categories, but the procurements are not being terminated. Can we put these audits issues into perspectives? The mission of the Air Force obviously is to deter aggression, and if necessary, win wars by sweeping every aircraft from the skies and enabling our own aircraft to deliver weapons that will break the power of any enemy to hurt this Nation. Today, we are asking how that task can be performed with signficantly greater efficiency.

Over the last few years, this country has been rocked by repeated incidents of fraud, waste and mismanagement in Government. Responding to my concerns in this area, the Office of Management and Budget, in December of last year, issued a list of over 100 high risk areas in Government involving 16 different Federal agencies. And last month, the GAO, also at my request, also published a list of 14 high risk areas potentially vulnerable to fraud, waste and mismanagement. The OMB list identified five high risk areas within DOD and the GAO list identified two areas.

In examining these high risk areas, one of the major threads which weaves itself through many of them is the inadequacy of the financial information systems in these high risk programs. Government managers, including the Congress, clearly do not have access to adequate and accurate information needed to manage Federal programs and to protect the public monies entrusted to them.

The seriousness of the financial information void is forcibly being brought to our attention today with the release of the GAO report on the condition of the Air Force's financial management system. The results go to the heart of the Congress' ability to rely on the information provided to it by the Department of Defense.

At the same time, while the results of the report are indeed serious, what is even more troubling is that GAO picked the Air Force as the first of the services to be evaluated from this financial standpoint because the Air Force presumably has the best financial management system among the services.

If the Air Force does indeed have the best financial management system among the services, then the aduit results are an indictment of the financial management systems of the whole Department of Defense—Army, Navy, Air Force, Marines, everybody else. If anything, the Air Force should be commended for, at the very least, attempting to develop a set of financial statements which conform to generally accepted accounting principles for Federal agencies. None of the other services, according to GAO, has even really attempted to do this yet in any serious way. I commend the GAO for its work on this report, and look forward to a series of such reports to this Committee as we proceed through this year and beyond.

Finally, I cannot help but view the results of this GAO report as a further confirmation of the need, which we have discussed many times with the Comptroller General, for a chief financial officer for all the Federal Government, as well as for each major Federal agency. We need someone at the top who can speak directly to the President. It is clearly going to take the type of commitment which a CFO can provide to straighten out the financial mess we have in Government today.

I would note that in the past we have had testimony from the GAO that at one time they had identified some 400 different accounting systems in the Federal Government—different accounting systems. I did not know anybody could design 400 different systems, but they had picked up 400 different systems. I think they identified that the Air Force itself has some 131 different financial and management situations that should be simplified.

Now in all fairness I want to make clear that the Air Force obviously does not agree with some of the conclusions that GAO has reached. They have put out a letter in which the Secretary of the Air Force discusses GAO's report in general terms and will respond to it in more detail later. I want the Secretary's letter to be entered in the record today also, so this will be as complete as we can make it today.[1]

I also would note that we asked the Air Force to be here today to testify on their view of the situation. They declined. In their absence, I will put the Secretary of the Air Force's letter in, and we hope to have the Air Force appear at our hearing, probably on the 6th of March. We are trying to arrange that, although it has not been decided for sure yet as to whether it will be combined with another hearing or be a separate hearing.

[The prepared statement of Senator Glenn follows:]

PREPARED STATEMENT OF CHAIRMAN GLENN

This morning the Governmental Affairs Committee meets to examine a wide ranging financial management audit of the United States Air Force. The General Accounting Office selected the Air Force for its first comprehensive financial man-

[1] See p. 170.

agement review because it is the only military service that has attempted to develop a set of financial statements in accordance with generally accepted accounting principles for federal agencies. This hearing was originally scheduled for some time in March, but the leak of the draft GAO report to the Washington Post caused us to alter our schedule.

The Air Force has resources valued at about $275 billion and receives almost $90 billion in annual appropriations. It operates over 130 bases located throughout the world, representing about 16 percent of the real property held by the U.S. government. The Air Force manages a reported $99.1 billion of weapons systems (aircraft, missiles, and engines) and a reported $63.8 billion of inventories of supplies and spare parts, which amounts to about 20 percent of the equipment and almost 30 percent of the inventories held by the U.S. government. The Air Force employs about 900,000 civilian and military personnel.

This audit is historic since it is the first time such a comprehensive effort has ever been undertaken. It required approximately 25,000 days of GAO audit time and undoubtedly required thousands of hours of time from the Air Force. According to Comptroller General Bowsher's report the Air Force's financial management systems and internal controls are "not sufficient to provide adequate and reliable financial information for effective management of the Air Force's diverse and complex operations." What does it really mean to members of the Senate or the public if the Air Force's accounts are "unauditable," and are "inaccurate or unreliable?"

First, it means the Congress may be presented with and make major decisions to procure weapons systems where the true cost of already procured weapons is unknown, and where there is a consistent pattern of understating such cost. For example, the Air Force claims that the cost of a single B-1-B bomber is $150 million. GAO believes such "flyaway" costs are incorrect because they fail to account for other items necessary to bring the aircraft up to mission capability, and that the true cost of a B-1-B is $219 million. Such a difference in cost results in a staggering difference of "financial" opinions: did the B-1-B program cost $21.9 billion, which the Air Force claims, or an additional $7.1 billion? Similarly, GAO believes the cost of the F-15 program is understated by $6.8 billion, and the F-16 by $6.3 billion. That's real money, and it really shows that with more accurate information, major decisions to procure might change based on the cost differences. If the reported costs of military hardware are "grossly understated" and acual costs cannot be determined, it confirms that we cannot make the best decisions with the taxpayers' money. The Air Force believes the Selected Acquisition Reports, provided to Congress on major weapon systems, reflect these costs more accurately, and that GAO's point in this regard is not well taken. The fundamental question facing the Congress is, if the financial information provided by DOD is as bad as the GAO report suggests, how can the Congress rely on the budget and other information which DOD provides it? Do we have to add a fudge factor to all of DOD's budget and cost estimates to account for the understatement of costs?

Second, the Air Force rightly measures its success on mission readiness—getting airplanes fueled, loaded with bombs and on the way to a target—not whether its financial accounting systems are adequately tracking expenditures. But when financial accountability is lost and inaccurate cost information exists, commanders of similar air wings, or bases, may achieve equivalent degrees of mission readiness by far different levels of efficiency and costs. Unfortunately, the lack of adequate financial data does not permit the Air Force the "visibility" to see such differences. As a practical matter, this means the Air Force is no more likely to promote the efficient wing commander, or have his methods and techniques copied at a similar base, depot or command.

Third, in the absence of adequate financial management information and systems it is equally clear that the Air Force has purchased 11 billion dollars in spare parts for aircraft and systems it will never use, or could have purchased at a significantly later time when the need for such items was more clearly defined. (The Committee will be holding a hearing on this specific issue on March 6). Without information, even items that are on-order fall into these excess categories, but the procurements are not being terminated.

Can we put these audit issues into perspective?

The mission of the U.S. Air Force is to deter aggression, and if necessary, win wars by sweeping every aircraft from the skies and enabling our own aircraft to deliver weapons that will break the power of any enemy to hurt this Nation. Today we are asking how that task can be performed with significantly greater efficiency.

Over the last few years, this country has been rocked by repeated incidents of fraud, waste and mismanagement in government. Responding to my concerns in this area, the Office of Management and Budget, in December of last year, issued a

list of over 100 "high risk" areas in government involving 16 different Federal agencies. Last month, the General Accounting Office, at my request, also published a list of 14 "high risk" areas potentially vulnerable to fraud, waste and mismanagement. The OMB list identified five high risk areas within DOD; the GAO list identified two areas.

In examining these high risk areas, one of the major threads which weaves itself through many of them is the inadequacy of the financial informations systems in these high risk programs. Government managers, including the Congress, clearly do not have access to adequate and accurate information needed to manage federal programs and to protect the public monies entrusted to them.

The seriousness of the financial information void is forcibly being brought to our attention today with the release of the GAO report on the condition of the Air Force's financial management system. The results go to the heart of the Congress' ability to rely on the information provided to it by the Department of Defense.

At the same time, while the results of the report are indeed serious, what is even more troubling is that GAO picked the Air Force because it presumably has the best financial management system among the services.

If the Air Force does indeed have the best financial management system among the services, then the audit results are an indictment of the financial management systems of the whole Department of Defense—the Army, the Navy as well as the Air Force. If anything, the Air Force should be commended for, at the very least, attempting to develop a set of financial statements which conform to generally accepted accounting principles for federal agencies. None of the other services, according to GAO, has even attempted this. I commend the GAO for its work on this report, and look forward to a series of such reports to this Committee as we proceed through this year and beyond.

Finally, I can't help but view the results of this GAO report as a further confirmation of the need for a chief financial officer for all the federal government as well as for each major federal agency. We need someone at the top who can speak directly to the President. It is clearly going to take the type of commitment which a CFO can provide to straigthen out the financial mess we have in govenment today.

Chairman GLENN. With that Senator Cohen.

OPENING STATEMENT OF SENATOR COHEN

Senator COHEN. Just a couple of words, Mr. Chairman, I want to first commend you for calling the hearing which might more appropriately be called "Coming to America." I had occasion to talk to one of your staff members on the way over and it seemed to me that we have a Buckwald column in the making: a situation where one film grossed $300 million and showed no net profit. There may be similar types of accounting practices to be found here as well.

I want to just raise a question about what it is exactly that this staff report means? It seems to me that some of the conclusions reached in this particular draft statement have been taken out of context. The statement does not say what certain facets of the press have represented it to say.

For example, there was a report last evening that indicated that the Air Force has been lying to Congress for over a decade about the cost of the B-1-B. That is not what I gathered from this report. The GAO rightly, I assume, criticized the internal financial management system adopted by the Air Force. I think it is called, AVISURS—Aerospace Vehicle and Equipment Inventory, Status, and Utilization Reporting System.

Now it shows according to the GAO that under this particular internal accounting method, the B-1-B costs $14.8 billion, but in fact the SAR's—the Selected Acquisition Reports—which are the ones that come to Congress, have shown the cost to be $21.5 billion. While the GAO criticized the accuracy of the SAR's, it is fairly close to what the GAO found as being $21.9 billion in terms of the

cost. The SAR figure is the one that has been given to Congress. It has not been the $14.8 billion figure. That is not what has been banded about the halls of Congress in terms of supporting the B–1–B. It has always been roughly $20 or $21 billion, and I assume that is in end year dollars in 1981.

For the media to suggest that the report says that the Air Force has been lying deliberately to the Congress for the past decade. I do not think it is accurate.

Mr. BOWSHER. No, that is not accurate, Senator, and I will get into it. In other words, I think you have had some problems as far as the information coming to Congress, but——

Senator COHEN. Let me finish.

Mr. BOWSHER. Because nowhere in our record did we say that they had been lying.

Senator COHEN. This does touch upon the point that the Chairman has made that it would be nice for the Congress to receive the report first, or at least have it in our possession to review, before it is released to the media, rather then find ourselves trying to deal with allegations that are in fact inaccurate. Again, I am sure that no one on the Hill has ever used the $14.8 billion figure in assessing whether to support or reject the B–1–B. It simply has not been the case. Anyway, I will not take more time on this, Mr. Chairman, but it seems to me that a report indicating that a B–1–B costs $7.5 billion more than the $28 billion reported is also inaccurate, according to what I have seen in your report. That is not what you have said.

The Air Force may have a great deal to account for and it may have a totally inadequate financial management system, but I do not believe what I have seen in the press so far accurately characterizes what you have said. I look forward to hearing what the facts are, so that we can make a proper judgment.

Chairman GLENN. Let me comment on the availability of the report. I just received my copy late yesterday, too, and stayed up to about 12:30 this morning reading it, so I would be prepared for this morning's hearing. I moved yesterday afternoon to get it reprinted as rapidly as we could get it around to everybody. I am sorry we could not do it any more rapidly.

Senator COHEN. The only point I am making is that it has been characterized in a way that I think is inaccurate for our purposes.

Chairman GLENN. Senator Lieberman.

OPENING STATEMENT OF SENATOR LIEBERMAN

Senator LIEBERMAN. Thank you, Mr. Chairman, for convening this hearing and thank you Mr. Bowsher for your outstanding work. I look over the report quickly and I greet you this morning with a combination of outrage and hope. I found it startling that the Air Force apparently does not have in place the kinds of accounting systems most small businesses consider routine and critically necessary.

Every small businessman or woman that I deal with in Connecticut knows that an accounting system is critically important to proper management. That is the way that businesses not only protect themselves against fraud, embezzlement and thievery, but also

gather the kinds of cost and expense data that are essential to proper planning and budgeting decisions. Without that kind of accounting system, businesses cannot make those decisions. And I think it is a classic example of the principle, which we have talked about before in this Committee, of "garbage in and garbage out."

Mr. Chairman, the person who has more money in his possession than he knows what to do with is really the only person who can afford to be a sloppy bookkeeper. And it is certainly a luxury the Government cannot afford with the taxpayer's money. As a nation, we are facing staggering deficits. It may have been the case that over the last 10 years the Air Force felt like that person who had more money than he knew what to do with. But the reality today is that we have a lot less money than we need to meet our problems, and as a result we cannot tolerate the kinds of abuses your report suggests.

I feel this with a particular poignancy as a Senator who comes from a State where tens of thousands of workers depend on the Defense industry and where we feel the need, particularly in this hour of shrinking budgets, for good management and a good allocation of our Defense money. It is extremely troubling to learn from your work that the Air Force cannot accurately assess its inventories, which leads to the tremendous potential for inappropriate and wasteful procurement decisions.

According to GAO, the financial information the Air Force provided the Treasury Department—which the Treasury used to prepare consolidated Government reports for Congress—is repeatedly unreliable. The Air Force does not accumulate, account for, or report the actual procurement costs of aircraft or missiles, nor does it include materials furnished to contractors by the Federal Government, when it calculates the cost of weapons systems. I find that startling.

As Senator Cohen referred to generally before, GAO found that even without including the cost of Government furnished materials, the Department of Defense report to Congress understated the cost of the B-1-B bomber by $400 million in 1988. The real cost of producing an aircraft or missile, according to your conclusion, is not known, and cannot be reported to the Congress or other decision-makers. This makes it impossible for us as representatives of the American people to even begin to make intelligent policy decisions.

Finally, I find it incredible that the Air Force does not make maximum use of the financial information it does obtain to manage its existing resources effectively. Again, the GAO found that Air Force managers have not routinely analyzed available data to identify problems or potential problems within their operations. That kind of mismanagement just invites waste. What I fear, as the Chairman suggested, is that this is the tip of the iceberg. The Air Force was selected for this audit because it is supposed to be in the best financial shape of any of the agencies of the Defense Department. I hate to think about what we are going to find in future audits of the Army and Navy.

And it suggest a broader problem across our Government. Mr. Chairman, dealing with painfully inadequate financial or accounting systems in Defense and other areas of our Government is one

of the great important and most difficult challenges we face in the coming decade as we try to balance our books and meet pressing domestic needs.

I know that Mr. Bowsher will be a critically important ally and aide in this effort, and that you, Mr. Chairman, through this Committee, will lead us to make a real contribution in that important work. Thank you.

Chairman GLENN. Senator Sasser.

Senator SASSER. Mr. Chairman, I would just like to commend you today for convening this hearing. We have been alarmed in the past few weeks of reports of mismanagement at the Pentagon as it relates to excess inventory of spare parts, totalling tens of billions of dollars. And I want to commend you today for convening this hearing and I look forward to hearing the testimony of General Bowsher and his associate. Thank you.

Chairman GLENN. Thank you very much. The people at the table today are—the Honorable Charles Bowsher, Comptroller General; Mr. Donald H. Chapin, Assistant Comptroller General for Accounting and Financial Management; Frank Conahan, Assistant Comptroller General for National Security; and Terry Carnahan, Assistant Director, Accounting and Financial Management Division.

Mr. Bowsher, welcome again. We look forward to your testimony.

TESTIMONY OF CHARLES A. BOWSHER, COMPTROLLER GENERAL, U.S. GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY DONALD H. CHAPIN, ASSISTANT COMPTROLLER GENERAL FOR ACCOUNTING AND FINANCIAL MANAGEMENT, FRANK CONAHAN, ASSISTANT COMPTROLLER GENERAL FOR NATIONAL SECURITY AND INTERNATIONAL AFFAIRS, AND TERRY CARNAHAN, ASSISTANT DIRECTOR, ACCOUNTING AND FINANCIAL MANAGEMENT DIVISION

Mr. BOWSHER. Thank you very much, Mr. Chairman and the members of the Committee. I am just going to summarize my prepared text [1] and maybe read the last two or three pages of it. I think the important thing here is that we have tried to do this financial audit—as you have pointed out it is the first one that we have ever done on one of the large military services. We thought that it was absolutely necessary to do a financial audit of one of the large services because we believe, as you are well aware, Mr. Chairman, that there should be financial audits on all the large departments of the Federal Government.

Now I want to commend the Air Force for being willing to try to do it, and I want to also point out that we had a very fine cooperative effort by many people in the Air Force in the last 2 years in trying to do this audit. We ran into many more problems than we expected and I think many more problems than they expected. But on balance the civil servants and many of the officers in the Air Force were very cooperative and tried very hard to come up with financial statements that could be auditable.

The unfortunate net result is that when we looked at the final results of our audit, we had to conclude that 70 percent of the

[1] See p. 45.

assets were unauditable. We had looked at the systems and we found, as you pointed out, that they had 131 systems. They really basically lack a double entry, general ledger system. Most of their systems are what is known in the accounting world as single entry, and therefore you have some real problems. And the Air Force has already concluded they want to move to a double entry general ledger system.

Now we also found that many of the accounts were not under accounting control and therefore you have no assurance of material errors and omissions did not occur. For instance, the aircraft of $82 billion or the missiles at $10 billion, and the aircraft under construction of $15 billion are accounts that were not really under what is known as accounting control.

Now if you look at the information that is flowing from the Air Force through OSD to the Treasury and to OMB, you also find very substantial problems. In other words, in the September 1988 report one of the problems we ran into is that some of the data that was being supplied by lower commands was old data. In other words, they would send up the March 31, 1988 data, rather than the September 30, 1988 data. For instance, one of the consequences of that is that the assets were understated by $534 million and the liabilities by $29 million.

The Treasury statement that is required each year, known as the 220, did not include $18.2 billion for aircraft and missiles and it overstated the intra service transactions by $10 billion. I noticed in looking at these statements that there were significant changes in the account balances between periods that were not analyzed. That is just normal good financial management practice—to look at an annual statement and say what accounted for these differences.

We also noticed that we had credit and negative balances in asset accounts. Now I might point out that back in 1968 when I served as Assistant Secretary of the Navy, it was those kind of things that worried me when I saw the first annual statement that I was asked to send over to the Treasury. To me that is the kind of red light that should go on when you have problems with your financial records. I might also point out at that time that I had one of the large CPA firms come in and do a review and we found many of these same problems at the Navy at the time in the late 1960's. We tried to put forward a program of reform and unfortunately people later on killed that reform effort.

So I suspect when we go in and look at the Navy, we are going to find many of these same problems. But when you see credit balances in asset accounts, to me that is a red light for any financial report.

Many of the accounts were not reconciled with the subsidiary records, and as of September 30, 1988, the Air Force systems command had not reconciled $7 billion in disbursements with the obligation records. In other words, the checkbook you are using for paying people had not been reconciled back to the obligations or the purchasing records that you have.

We saw many unsupported arbitrary adjustments. For example, at the Space Division this was $2.4 billion; at Sembach it was $214,000; at Systems Command it was $500,000; at Ogden, it was $241 million. You have already pointed out the difference between

the accounting records and on the major weapons systems, the B-1, the B-52, the F-15, and the F-16. The B-1 was understated by $7 billion; the B-52 by $1 billion; the F-15 by $6.8 billion; and the F-16 by $6.3 billion.

Now if I could just illustrate a little bit for Senator Cohen one of the problems with the SAR reports. You are right that the final B-1 that we looked at came closer to what we thought was the right thing. But one of the things we examined was to see that they had many things in there that we did not have in our total. So it is more of a coincidence than it is a fact that you were getting relatively accurate information.

Senator COHEN. Mr. Bowsher, the only question I had if I could, Mr. Chairman, is whether or not the SAR that is submitted to Congress is very close to a number that you are talking about so that we were looking at a figure roughly in the field of $21 billion, and not the $14.8 decided by the Internal Management System?

Mr. BOWSHER. The final SAR report was closer to the one that we thought it should be. That is correct. And in no place in our report did we say that the Air Force lied to Congress. But I do believe that one thing that is important that you should understand about this SAR and one thing we have been advocating for a long time, and that is the cost information in the SAR should be tied to the accounting records. In other words, they are not. So that if you look at the past year reports on the SAR's, we have been critical of many of those things. And so I do not think that Congress is getting accurate information on many of them. Not because people are trying to lie to them, but it is just that the system is not in place to give you the accurate information.

Senator COHEN. Mr. Bowsher testified, Mr. Chairman, on many occasions before this Committee about the inadequacy of the SAR's and the other accounting systems. So we are in total agreement. My only point was that I think the report was taken out of context to represent a deliberate falsification on the part of the Air Force to the Congress, and I think we had roughly the figures presented to us by the Air Force as you do today.

Mr. BOWSHER. The modifications, Mr. Chairman, being at the Bureau there, you know that modifications can be a big sum of money and what we found is that modifications of $25 billion had not been capitalized since 1973. I think another thing we found too is a tremendous problem in trying to locate what the operating costs were in some of these programs.

I remember Bill Clemons, who is now the Governor of Texas and he served as Deputy Secretary of Defense, telling me some years back when he was at the Pengaton, that one of the most frustrating things he found was he wanted always to compare some things—what was the cost to run a motor pool or what is the cost of keeping some of this excess inventory. And he always found it very difficult and impossible to make management judgments because he never could get the cost figures on some of those operating areas. And again this financial audit pointed that problem up.

Lack of controls of contractor held property—$630 million in satellites due paid contractor, $18 million to store; $57 million in the C-28 cargo plane engines. The GFM, the government furnished material is not a track record accounted for. Now the Air Force has

recognized this for some years and I believe in the Secretary of Air Force's letter, he has pointed out that they plan to do something about this.

The point I want to make though is that we had many, many promises here to improve these systems and this is a very important area. Frank Conahan on my left here tells me that the latest figure we have in Defense, based on a system that they have now put in asking the conractors to send in information is that the material might be as much as $50 billion?

Mr. CONAHAN. $56.5 billion.

Mr. BOWSHER. $56.5 billion. So we are not talking about small money here and we are not accounting for it properly. That is really what it comes down to. Now in the inventories, again we found here that the records were inaccurate, the perpetual records were inaccurate, even when they do not have dollars assigned to it, it was reported, as Senator Sasser pointed out about the excess inventories which run about $10 billion, up maybe around $13 billion in current terms right now for the Air Force. And that is 57 percent of the ALC investments. That is items that were unserviceable, so you have $7 billion there. There can be some overlap between that $7 billion and the other $10 or $13 billion.

And the evaluation policy of the Air Force themselves was not being followed in pricing out the inventories. So this is an overall summary of the problems we face and I know that in the Secretary's letter too, Mr. Chairman, he has raised the fact that the Pentagon has other management systems and that these accounting systems might not be correct, and therefore that is a problem. But it should not indicate that we do not have other systems that management is using to manage the Air Force and to manage the Pentagon.

I would like to just address the three systems though that he addressed in his letter. One if the Planning Programming Budgeting System which is the old McNamara system, PPBS, which is in place and still working at the Pentagon. The end result of that system is the 5-year Defense plan, one of the end results of that system. And I believe as we have reported to the Armed Services Committee in our hearings in the last 2 or 3 years that the information coming out of that has been very very inflated.

In other words, in the decade here starting with 1982, you really had those numbers showing $2 trillion of program over and above what the budgets were enventually able to fund. Last year we testified that it was about $150 billion over budget and today, why you Committee is having a very hard time getting the information. In fact, we have been working with Senator Nunn and Congressman Arlen. So the Congress is not getting information out of that system.

The second system he raised is the SAR system, and I have already discussed one of my major concern about the SAR system; the cost information is not rooted in the basic accounting system. So what you are getting there is what the program office each time feels is the best information that they have, and over the years we have reported, as I said earlier, that this report is not what it should be or could be. That system was put in by Mel Laird and Dave Packard when they found out the original cost overrun of the

C-5-A, and they asked all the other services how much cost overruns do we have at the Pentagon. And we came up with something like $16 billion, if I can remember the number, which was a very large number at that time.

So we put this SAR system in, not only to give Congress the information on the major weapons, but also the top management of the Pentagon. And I think it is basically a good system, but it just has never really been put in place and worked the way it should to really assure yourself that you are getting accurate information.

The third system that he mentioned was the cost-estimating system, the independent cost analysis system. And I think as most of you who have worked on cost estimates for projects all know that you have got to go back and look at actual costs to see how well your cost estimating is doing. If you do not have accurate costs in your cost records, then it is much more difficult to know whether your cost estimating of future weapons is doing well. Now I know that most of this is done by economic techniques of using models and everything like that and when you move from an airplane like the B-1 and B-2, or I can remember when we moved to the F-14, the F-15, we are moving from aluminum to titanium and now we move to composites. So some of the historic information is not as important. There is no question about that.

But a lot of the cost estimating is done on things that do not have that quantum jump in technology and so knowing what your actual cost were on previous models is valuable, and I think it is valuable just to test out how good is your cost estimating. So what I am saying is the three other systems that were identified have real problems too. So in the balance, I think, that this audit report on the financial records and that does indicate an overall problem of not having good information and certainly not having the controls over assets.

When we talk about fund control, the Air Force system is pretty good on reporting on the budget appropriations, that is talking about the $90 billion that the Congress has appropriated for the coming year. But this is an organization that has $270 billion of assets—$63 billion of inventories. So you have to have controls over those kind of assets if you are going to manage an organization like the Air Force.

What we are really saying today, unfortunately, is that the audit indicated that we do not have those controls. Now if I could just read the last three pages of my statements which really goes more to the rest of the Government, I would like to do that and then I would be very pleased to answer any questions.

But starting on page 15 of my statement I say. The Air Force audit illustrates why we do not reliable financial statements for Federal agencies. There are still some who insist that traditional Federal financial management practices are adequate and the financial statements and audits are not needed in Federal operations. I would like to put these notions to rest.

Almost universally, our financially audits of civil agencies, as well as the Air Force, have revealed systems problems which are so severe that the financial information needed to manage agency operations as well prepare agency financial statements are seriously deficient. These problems are generally more serious and deep-

seated than either we or the agency managers realized before the audit. We believe the process of trying to prepare financial statements forces full recognition of the systems problems. The process is like an early warning sytem, an often overlooked value and which derives from the preparation of agency financial statements.

Our financial audits have disclosed that those sytems which do exist are not designed to aid Government managers to operate in a cost-effective manner, or to prevent mismanagement, fraud, waste and abuse. These essentials must be addressed when reliable financial statements must be prepared. This is because statements cannot be prepared without addressing systems issues and related internal controls.

Reliable cost information needed to manage in a cost-effective manner flow from the good accounting systems necessary to prepare financial statements. Management controls which operate to prevent mismanagement, fraud, waste and abuse are also required to produce reliable financial statements. The appalling list of high-risk areas recently published by OMB highlights the need for these reliable financial statements prepared by Federal agenices. Many of the items that OMB identified result from or are related to accounting systems problems.

Why cannot the agencies just fix the systems and not bother with financial statements? Well, theoretically that is possible, but practically impossible. The agencies need the discipline of having to prepare reliable financial statements which satisfy standards set by independent auditors, such as the GAO, in order to focus on fixing the underlying systems. You might view audited financial statements as a report card which will point out seriously deficient systems, help quantify the extent of the problem and highlight what needs to be done. Until an agency can achieve unqualified financial statements, its systems will be seriously deficient, the information derived from those systems that goes to the Congress and others will be incorrect, and it cannot be cost effective. That is the financial statement report card.

Also, I want to emphasize that improving financial management in the Federal Government has been an importance objective of GAO, OMB and Treasury. In 1988, the Secretary of the Treasury, Director of OMB and I collectively issued standards for these core financial system requirements. Those standards represent a major step in improving the Federal financial management systems and will provide greater consistency and reliability to department and agency financial systems and improve the reporting.

What we have found in our audits of the Air Force and other agencies and Government corporations is that the true financial situation of these entities had not been disclosed to the public, the Congress, OMB and the Treasury. What we have found is that the agency managers did not understand the financial condition of their agencies before they tried to produce these auditable financial statements. As the report demonstrates, the financial information reported to Congress and OMB by the Air Force was wrong by significant numbers.

One of the other things that I feel fortunate in the Secretary's letter there, Mr. Chairman, is he kind of infers that we want penny accuracy. We do not want penny accuracy in these large

Government agencies, but we want reasonable accuracy in these accounts.

In addition, we noted that the Air Force statement line items should be adjusted by amounts; which are not calculable at this point in time. We roughly estimate that equipment and missiles are misstated by billions of dollars and aircraft and inventories are misstated by tens of billions of dollars.

Moreover, additional analysis during our fiscal year 1989 audit shows that the budgetary system processed about $12 billion in budgetary transactions—that is expenditures in 1988 that was not recorded in the general ledger accounting system. For fiscal year 1989, we estimate that an additional $23 billion was not recorded. This if, I can point out there, is the work that we are doing in the next fiscal year. In other words, we are finding additional large sums of money here. Air Force finance officials estimate that several billions of dollars of expenditures were for classified assets which are not recorded in the accounting system for security reasons. While they could not specify the amounts for the remaining expenditures, they agreed that they represent assets that are recorded in the accounting systems at different costs than actually incurred, or Government-furnished materials provided to contractors, and consumed inventories.

I just might say again in my closing paragraph here that I want to recognize that the Air Force did work well with us on this project, did put in a lot of effort, and were very cooperative, and we really do look forward to working with them to try to improve this situation. And we also plan to review both the Army and the Navy here in the near future.

Thank you, Mr. Chairman.

Chairman GLENN. Thank you very much. We will go 5 minutes per person and follow our early bird rule on the Committee. You mentioned the classified accounts, the black programs. You did not include the black programs in your audit effort with the Air Force, I gather?

Mr. BOWSHER. That is correct, Mr. Chairman. We have issued some other reports, as you are aware, on some of those programs, but in this financial audit, we did not include that.

Chairman GLENN. Do you have any estimates of what would be involved? How many tens of billions of dollars would be involved in those programs because an increasing number of programs have been black programs?

Mr. BOWSHER. I think we do have, and maybe it would be good if we supplied that for the record.[1]

Chairman GLENN. If you would do that, we would appreciate it. There are news reports on the B-2 cost rising, one in the morning paper, as a matter of fact. And that the FBI has been in Northrup and so on, and the costs going up dramatically. Do you have estimates on that program you could give us this morning?

Mr. BOWSHER. We do. Frank Conahan here on my left is the one that did the testimony on the B-2. I think Frank can give you the estimates that we have.

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[1] The information referred to may be found in the Committee files.

Mr. CONAHAN. The estimated cost of the B–2 has risen significantly each year since 1986 when the Air Force first publicly announced the program with a then cost of $58 billion. Each year thereafter we estimated the cost. The most recent estimate is in June of 1989, last year, at $70.2 billion. That is a net increase of some $12 billion. It really comes about by increase of some $18 billion and projected cost savings of $6 billion. They projected they will go into multi-year procurement, but there will be some component breakout and that sort of thing which will net them savings.

We think those projections are overly optimistic and that perhaps some of them really will not be achieved. So the $12 billion increase likely will be higher. But beyond that, they have made some recent re-estimates and there will be increases beyond that. For example, this last year they increased their inflation estimates across the board. They added something like $51 billion to the overall 5-year Defense plan. Some portion of that is for the B–1. I do not have that number. The B–2, I am sorry. Thank you, Senator.

We had a strike at Boeing. That added costs to the program. So it will be several billion dollar beyond the $70.2 official estimate.

Chairman GLENN. Do those figures include Government-furnished material?

Mr. CONAHAN. To the extent that we have Government-furnished material, yes, sir.

Chairman GLENN. Like avionics systems and things like that which are furnished separately?

Mr. CONAHAN. Yes, sir.

Chairman GLENN. It does include that.

Mr. CONAHAN. Right. As a matter of fact, the avionics systems have increased rather dramatically. In the 1986 estimate, they were at $1.9 billion and in the most recent estimate, they are at about $5.7 billion. They have not been tested. Those systems do not get put into the test aircraft for some years to come. They will not be fully tested for perhaps another 3 years, so I think that we are going to hear some more about the rising cost in that area.

Chairman GLENN. Those figures would not be total program costs? Those figures do not include support costs, base cost and things like that?

Mr. CONAHAN. That is correct. Construction costs, such as for hangers are not at all included.

Chairman GLENN. Mr. Bowsher, on page 8 of your testimony that you did not read, but which you referred to in your comments, you state that since the mid-1980's, DOD's 5-year Defense planning has been fiscally unrealistic. More weapons were being planned and developed than could be produced in an economic manner or supported once they were produced. Since 1982, DOD 5-year spending plans have exceeded actual and current estimated funding by over $2 trillion. This is not an effective way for DOD to manage.

I can certainly agree with that. That is a bigger figure than I had seen before. Could you comment on that?

Mr. BOWSHER. Yes. It is the figure that I testified before the Armed Services Committee last year on May 10th.

Chairman GLENN. It is basically $300 billion per year times your number of years; is that correct?

Mr. BOWSHER. I am not sure it is quite that much, but what it costs was the fact that you had such a run up in the Defense budget in the early 1980's. You doubled the budget from $140 billion to $280 billion in 4 years. Then the plan was, if you remember, that it was going to rise just about that dramatic an increase for the rest of the decade with Cap Weinberger's plans there. And so that is what the fit-up and the PPBS system had in it as far as that much program. Then when the Congress passed Gramm-Rudman in 1985 and you leveled off literally at the high 200's—290, 295 and things like that, the Congress was not giving the monies that had been planned and yet the fit-up never got brought up-to-date.

The tough decisions on the out years were very slow in coming and as I said even last year which was 1989, we still had a bulge there of about $150 billion when we testified. So what you have had here, and as I say now they cannot even really get the FYDP from the Pentagon. So what you really have here is you have a 10-year period where the FYDP has been only marginally helpful to the Congress in trying to determine what are the out-year implications of the budget decisions being made at any one time.

Chairman GLENN. My time is up, Senator Cohen.

Senator COHEN. Thank you, Mr. Chairman. Mr. Bowsher, how long have you been reviewing accounting systems in the Federal Government?

Mr. BOWSHER. In the GAO?

Senator COHEN. Yes, the GAO.

Mr. BOWSHER. We have been reviewing them for many, many years.

Senator COHEN. Has there ever been an agency that you found to have adequate financial controls?

Mr. BOWSHER. Yes. Not recently, I will point that out. In other words, in earlier years, there was a number of agencies that were viewed as having systems that conformed with the standards of the GAO. And in fact if I could just give you 2 minutes of history here.

Senator COHEN. One minute.

Mr. BOWSHER. All right, 1 minute, and that is prior to the World War II, we were the General Accounting Office. After World War II, you had such a large Government here, you had to move the accounting back to the Executive Branch. Therefore, we became the auditors and we set the standards. So what we found there in the 1960's and the 1970's that some of the agencies conformed to those standards. Now with the enactment of the Financial Integrity Act and the reporting, we have all 18 major departments reporting that they do not conform to the standards which are the basic accounting standards.

Senator COHEN. What is it that prevents civilian and military agencies from adopting either a unified or an acceptable accounting system? What have you found that prevents them from doing this? You have been at this a long time and yet, you said until 1988, OMB, Treasury, and GAO had not recommended a system. Why has it taken so long to recommend a unified system for accounting for all of our departments, including the Air Force, DOD, and everyone else?

Mr. BOWSHER. There was a recognition this was needed but the Treasury has never designed what I would call that central archi-

tecture for the Federal Government, and the Defense Department has talked about it, but they have never had a central architecture for the services.

Mr. COHEN. Does GAO have one?

Mr. BOWSHER. The GAO does not have one and should not have one. In other words, we have the standards of what you should comply to. But it is now the Executive Branch, after the Act of 1950. It is the Executive Branch's responsibility. We did this in a joint effort with OMB and Treasury in 1988 and to get it out there. And I am hoping that if the legislation is passed with this Committee that we have talked about with the Chairman and other members here that we would then have the Congressional pressure on to modernize the systems and to have good information flowing?

Senator COHEN. What models should they use?

Mr. BOWSHER. They should use a model based on these standards, but they need to—I was just talking to Darman the other day about this—we have got to get an architecture plan from the Treasury, the chief financial officer of the Executive Branch as to what they need. And the standards we are calling for are just basic accounting. In other words, we are not talking about anything exotic here. We are just saying—what is your inventory, what are your receivables, how much do you owe people?

Senator COHEN. What is the problem? Why has it not been done before?

Mr. BOWSHER. The initiative has not been there. I tried to talk to David Stockman in the leadership in the early 1980's about this and they just did not want to take the initiative.

Senator COHEN. Mr. Conahan, could I just talk about the B–2 for a moment. You indicated the costs are going up significantly and the $70 billion figure does not include operating costs or storage sites, correct?

Mr. CONAHAN. Correct.

Senator COHEN. What is the estimate that you have on what it would cost to operate, repair and keep up a B–2 bomber on an annual basis?

Mr. CONAHAN. I do not have an estimate on that, Senator.

Senator COHEN. Do you have anything based upon what it has cost the B–1?

Mr. CONAHAN. I can give you numbers on the B–1.

Senator COHEN. Could we not use that as a basis when Mr. Bowsher said we can look at what we have done in the past in the way of costs, and then use that as a baseline, perhaps, to extrapolate into the future?

Mr. CONAHAN. The cost associated with the B–2 in some areas are significantly different. We need hangers for the B–2. We do not need them for the B–1. We have got different maintenance costs associated with the composite materials than we had for the B–1. I have not seen the Air Force studies that make those analyses.

Senator COHEN. Mr. Bowsher, if I can come back to the final point about the representations to Congress. Your report is not clear to me. For example, on Table 4.1, it indicates that the B–1 costs, reported by the SAR was $21.4 billion which is about a 2 percent difference between your estimate and that of the SAR.

There is another statement on Table 4 on page 48 that shows that the internal management system reported by the Air Force, it was $14.8 with a difference of about $7.1 billion?

Mr. BOWSHER. Yes, in fact, that is in the chart on page 52 right above the other chart.

Senator COHEN. There is some inconsistency on page 5-A in which you indicate that $21.9 billion is understated by at least $7.1 billion.

Mr. BOWSHER. Yes.

Senator COHEN. That is a little bit inconsistent with what you have on page 3 and how it is characterized. I suspect that is how we got the inaccurate reporting of what the Air Force had done, but what I want to know is, how do we get to the $14.8 billion internal management figure the Air Force was working with? Also, how did those who prepared the SAR's that are presented to Congress come up with their figure which is quite comparable to yours in terms of the actual cost? How did they do that?

Mr. BOWSHER. Let me explain how we went from the $14 billion to the $21 billion. In other words, in their accounting records, they had $14 billion. As we did the audit and looked at the document, we realized that there were costs missing, and so in working with the Air Force we came up and we said, the best figure we could jointly come together on is the $21.9 billion, and that is the difference of the $7.1 billion.

Then we looked over at the SAR report. And with the SAR report it came fairly close to that. Now that is the final SAR report that was issued. In that we found some differences between what we had and some other things like that, but it does come out.

Senator COHEN. The SAR report, though, is the one that comes to us and that is the figure that we use to base our decisions upon, and it is not much different than what your analysis is for the B-1; is that correct?

Mr. BOWSHER. On the B-1, that is correct.

Chairman GLENN. Thank you. Under our early attendance rules, Senator Lieberman.

Senator LIEBERMAN. Mr. Chairman, again thank you, and Mr. Bowsher and all your staff for your supportive work. I think you really give a good name to public service. I understand from the report that you have identified a woeful lack of basic accounting systems in the Air Force. I wanted to ask you, however, to what extent do you think the problems had to do with the enormous run-up in funding for Defense programs that occurred during the 1980's?

Mr. BOWSHER. I think much of the problem in the inventories go back to that. In other words, I think the accounting systems, if they had been in better shape, should have alerted the managers that this very dramatic rise was happening, both in the total inventory and what is known as unneeded or long supply inventory. But I think the reason that that money to a great extent was being pumped in was there was so much money being budgeted there in those 4 years.

Senator LIEBERMAN. So it seems to me that one conclusion that could be drawn from your work is that no matter how large the operation is they need a basic accounting system that meets your

standards, and that here the consequences of not having a basic accounting system were greater because of the run-up in defense expenditures that occurred.

Mr. BOWSHER. I think if you do not have adequate acccounting and financal management lots of times things can be happening in your organization that you are not aware of it. I did the review for the Treasury Department in the middle 1970's in New York City when they were to give the Federal loan, and I often got the question if we had had adequate financial report in New York City in the early 1970's would we have had the New York City fiscal crisis, and I always had the answer, I am not sure.

But we certainly would have had early warning. We certainly would have had an indication that the city was getting into financial trouble. That I see is the same type of analogy here to the need and what you should have out of these better financial reports.

Senator LIEBERMAN. I appreciate that and I think that is a strong point. The other thing that strikes me, by way of comparison, is that in American business there is a sense today, as we go into the 1990's, that people are going to be doing what they have been doing before in a leaner way.

There is a great belt-tightening occurring, as you know, in business generally, which suggests that as we go into this new stage of world history we should not only be dealing with the cutback in programs, but also with trying to make existing operations function better, no matter how many programs we are running—to make it a leaner operation.

Mr. BOWSHER. I could not agree more, Senator, and I think the inventory area is one of the key areas. In other words, I think the United States industry has made tremendous strides to a great extent prodded by the Japanese on keeping their inventory down. And still it could become a very efficient manufacturer in their merchandising operation.

LMI, a think tank for the Defense Department has done some excellent work and GAO under Frank Conahan's direction has done similar work on the fact that the Pentagon inventory trends here have been exactly the opposite of the rest of the U.S. economy here in the 1980's.

So one of the things that seems to me as we have fewer budget dollars here in the next decade is we have got to find out how to manage these inventories much better than what we have and that takes systems. In other words, you have go to know what you have now, whether you need to reorder or not, and you can make great strides, I think, with the communications and computer systems that you have today, I think this is an area that great strides could be made.

But one of the problems is like Senator Nunn asked me the other day when we were discussing this. He said how much should we cut? And it is hard to know, if you do not know what your total inventory is. In other words, it seems to me you have got to have financial information to start to make those management decisions, whether it is Congress or whether it is the leadership of the Pentagon.

Senator LIEBERMAN. Thank you. Yesterday the Committee held a confirmation hearing for the nominee for OMB's administrator for

Federal procurement policy. Based on your work in the Air Force and generaly throughout the Government, what role would you say OMB has played in improving military procurement accounting systems, if any?

Mr. BOWSHER. I think it has been limited. I think they have tried to improve the procedures and the regs and things like that. Frank, you might have a better feel for this than I have, but I think on balance the OMB effort has not had that big of an impact on the Defense procurement area.

Mr. CONAHAN. I think I would have to concur on that. As you know, that post remained vacant for long periods of time over the past half dozen years, and therefore, it has not had the kind of influence in the procurement community generally that it was intended to have. So I quite agree with that.

Senator LIEBERMAN. Is it fair for us to conclude that you believe, based on your work, that there is a more informative role that OMB should play in military procurement practices?

Mr. BOWSHER. I think there are, but I think the main effort has to come probably at the Pentagon and the office of the Secretary of Defense.

Senator LIEBERMAN. Thank you. Thank you, Mr. Chairman.

Chairman GLENN. Thank you. Senator Sasser.

Senator SASSER. Thank you very much, Mr. Chairman. General Bowsher, I want to compliment you on the work that the General Accounting Office has done in this particular field, and I want to particularly compliment Mr. Conahan on his report of investigation into the B-2 bomber program. And Mr. Chairman, I am delighted that you are taking a leadership role in this whole problem of what I consider to be excess inventory and excess inventory management in the Department of Defense.

General Bowsher, a couple of weeks ago the Senate Budget Committee prepared a report on Defense spare parts management. And that report indicated a continuing problem with spare parts inventory in the Department of Defense and the purchase of over $30 billion of unneeded material at DOD. The Air Force alone has on hand, according to your report, as I read it, some $10 billion inunneeded and excess inventory.

The discouraging thing is that the Department of Defense seems unable to stop the purchase or procurement of these unneeded spare parts even when they know, for example, that they do not need them. You have done some first-class work here and I am just wondering if you and your staff have had an opportunity to review this Budget Committee report and would you comment if you have on whether or not your findings cause the same concern as these Budget Committee findings caused myself and others?

Mr. BOWSHER. No. We have reviewed that report and we are in basic agreement with the facts and information. The only thing I would point out, as I mentioned earlier, is that the $10 billion is up to $13 billion now. I believe Secretary Rice even used that figure the other day as the unneeded inventory in the Air Force. So your point is well taken and that is the trend has not been stopped.

I think also if I could just talk for a minute about the cost of maintaining all of this inventory. And I think one of the things we have noticed in some of the other work we have done is that a lot

of the inventory is being moved over to Europe and then it is being moved back to the United States. You are moving it around from one warehouse to another, so material handling costs in excess inventory generally is very costly. That is the type of information you should also be able to get out of a good accounting system, and that is, what is it costing to maintain excess inventory and things like that.

But you cannot get it and so excess inventory, the cost of maintaining it, does not really get focused in by leadership.

Senator SASSER. You are correct, it does not. But I can tell you this, I wear another hat as Chairman of the Military Construction Appropriations Subcommittee and during the decade of the 1980's, we built $700 million worth of warehouses just to house these inventories and parts, and we now find that many of these parts are sitting out in the weather because the warehouses are so jammed they do not have room for the excess inventory. We find that the Army has helicopter parts sitting out. The Navy has ships' propellers.

I know that you are going to review the Navy and Army next. I am sure they are looking forward with eager anticipation to the arrival of your auditors. I am discouraged frankly because I was under the impression the Air Force probably had the best audit system of the three services prior to this report that you have given us.

Let me ask you this, General Bowsher, there was an enormous run-up during the decade of the 1980's and early in the 1980's with regard to appropriations for the Department of Defense. We had spending going up at a colossal rate, and I think as a result we have had waste at a colassal rate. And your report that you presented here to Senator Glenn, I think, confirms that today. We have got to make some tough decisions here in the not too distant future.

I note that your colleague, Mr. Conahan, is quoted as saying with regard to the B–2 "that under the current acquisition plan, 31 B–2's will be on order and over $48 billion will be appropriated before anyone knows whether the B–2 will do its job."

Now considering the decisions that we are going to have to make with regard to funding in the future for many of these systems, I am just wondering if we could not cut the Defense budget substantially without doing any serious harm to our Defense or security capability? I say that in view of what I perceive to be the partial thrust of your testimony, that one of the problems thay have had is they have just been a washing money. They are not auditing their activities correctly. They do not have the proper accounting procedures. Maybe we would be doing them a favor if we cut them substantially and sort of focused their mind on how they are actually spending their money and shepherding their spare parts. What do you say to that, General?

Mr. BOWSHER. Next Thursday we are testifying before the Senate Armed Services Committee and so some of the areas that we think should be looked at for savings, we will be trying to identify that day. I do believe there are areas of savings; I really do. And I think that this whole issue of these major weapons being built on a concurrent basis, there is no question that a lot of testing is going on

today through the computer and wind tunnels and everything like that.

But Senator Glenn and I had a discussion some months back. We are taking a large risk and that risk did not really pay off on the B-1 bomber. In other words, we did not really test that plane and some of the key components of it until it was built and so we have a plane today that has some limited capabilities, and we had a tremendous cost over-run on it. So I really do believe that this B-2 is a program that the Congress has to look at very very carefully, because I think one of the things that got going in the early 1980's, in addition to the large rapid build up of the Defense budget, we got back to concurrency and now we do have some of these major weapon systems.

I served under Laird and Packard as part of my tenure over at the Pentagon and I became a convert to Dave Packard's concept of "fly before buy." It costs more money up front, but you know what you are getting. And I think in the F-16 and in the F-14, and in the F-15, we got some superb planes that worked, and although we had some cost overruns, why we ended up with the product. So I think that is a very key decision for the Congress on this B-2 program.

Senator SASSER. Mr. Chairman, if I could just conclude with this by saying to you, General Bowsher and to your colleague, Frank Conahan, I think you are striking a real goal for the taxpayers in your ongoing review and audit of the Department of Defense. Thank you.

Chairman GLENN. Thank you. Before we go to Senator Levin, I might note that all of you mentioned the computer studies and the modeling that are supposed to make us more accurate these days and I am sure they do, but we are also into complex structures and things that require a lot of additional looking at and are not all that certain yet themselves.

Mr. BOWSHER. I think that is especially true, Mr. Chairman, in the software area. In other words, we are more and more dependent on software in these weapons systems and we are depending on aerospace companies to produce this successfully, and I think when we look at some of the problems of recent years and the problems we have had here, we have got to be very careful. I am also very concerned about this new submarine of the Navy's, because I think again that is one that is going to be very dependent on software.

Chairman GLENN. On the B-2, since it has been mentioned here several times, I noted in the paper this morning that there were some 2,000 changes per month. I wondered if that was a misprint because it is an enormous number of changes per month; this was supposed to be the airplane that was so tested and so wind tunneled and so engineered that it was going to require fewer changes. As a result, it was believed we could automatically go into concurrency and produce them with confidence. Last year on the Armed Services Committee, we got the hurdle set in that it has to pass its tests because we were afraid it was going to require changes. I do not know whether that is a misprint or not.

Mr. CONAHAN. That is a correct number, Mr. Chairman.

Chairman GLENN. I would just as soon wait. I have taken up Senator Levin's time, so I will get to that later. Senator Levin.

Senator LEVIN. Thank you, Mr. Chairman. Let me commend you, Mr. Bowsher and your colleagues. I think the only way I could describe your findings is that they are staggering. If the people of the United States were fully aware of what is in your reports, the anger would roll over this place so quickly that there would be immediate action on the part of the DOD and the Congress. I want to start by just thanking you for sticking with this and bringing this to the public's attention. You are doing exactly your job, and we are all proud of you for doing that.

One of your findings is on page 6 of your testimony that the adjustments of the Space System Division's trial balance for March 31, 1988, of $2.4 billion, the adjustment you call a "plug" in order to get two accounts to agree, was improper. Now where I come from that is a strong word.

Mr. BOWSHER. Yes.

Senator LEVIN. Did you intend it to be that strong?

Mr. BOWSHER. Yes, we did.

Senator LEVIN. My question is what is the remedy for the impropriety?

Mr. BOWSHER. I think what you have got to do and you have just got to have financial reports that are being prepared be reviewed by senior people and the word has got to go out that we do not want old data being sent in—March data for September data. We do not want plug figures in there. How it comes about, because I have been doing some of these major reviews for many years now, is that when clerical people and accounting people are producing reports that nobody ever looks at, then they get sloppy. They get to the point where they say, well look it, they want this by such and such a day, we will send it in.

If I can go back to New York City illustration one more time and that is when I was called in there in the summer of 1975, why they had a nice annual report, very well printed and everything like that. And we could not get answers from them as to how some of these numbers got put together. So we finally went up to New York, took a big team up there, much as we did here, and we did the review, and we found out they were plugging figures to get the balances and just get the report in. They were doing it because nobody was reviewing it and looking at it.

I think that is just a total breakdown in the discipline of your financial management structure, and when you spend billions—we are spending a lot of money here trying to account for this. We built a huge Air Force finance and accounting center in Denver. We have a big one for the Army in Indianapolis. We have a big one for the Navy in Cleveland and so if we are going to do the accounting, let us do it right.

Senator LEVIN. Would it help if the Air Force had a double entry accounting system?

Mr. BOWSHER. Absolutely.

Senator LEVIN. What every other major business has is a double entry accounting system?

Mr. BOWSHER. That is right. That is right.

Senator LEVIN. You told us they have something like $270 billion in assets?

Mr. BOWSHER. In assets—$270 billion.

Senator LEVIN. And they do not have a double entry accounting system?

Mr. BOWSHER. And they do not have a double entry accounting in most parts of their accounting system; that is right.

Senator LEVIN. What do they say when you point that out?

Mr. BOWSHER. They say that they are going to do better and that they have some plans to do it and we agree with that. But what we really believe is—I would go back to the legislation that this Committee is considering, and that is, you have to have a target and you have got to have a plan to accomplish this in a number of years, and you have got to have the Congress insisting that they are going to get good information.

I have just been unable to do it through the Executive Branch. Senator Cohen was asking me earlier why have you not been able to do it? And although I will say that I am having some good conversations with Mr. Darman these days, and I am hoping that he is going to be on board with our legislative package here.

Senator LEVIN. Do you think you have gotten their attention?

Mr. BOWSHER. I think the HUD audit and this audit and a couple other problems here, I think they finally realize that they are going to have scandal after scandal, reports that are going to point out things that the average American just do not think should take place.

Senator LEVIN. Even though you have gotten their attention, you are not recommending that we rely on that?

Mr. BOWSHER. No, I think we need legislation. I really do.

Senator LEVIN. Let me quickly ask you some other questions. I see my time may be running out soon. You have said that the 5-year spending plans have been estimated improperly. They have exceeded the actual spending and funding by over $2 trillion?

Mr. BOWSHER. Yes.

Senator LEVIN. Is that partly a buy-in problem or are they just estimating low in order that we will sign on to a program by——

Mr. BOWSHER. No, that problem really is. The fact is that you had those big run-ups in the budgets in the early 1980's and then they just continued to assume that they were going to get that kind of increase in the latter part of the 1980's.

Senator LEVIN. So part of the problem, here, is that we threw much too much money at Defense too quickly?

Mr. BOWSHER. Right.

Senator LEVIN. The next question has to do with this excess inventory. How much of it should be written off?

Mr. BOWSHER. I suspect a good portion of the $10 to $13 billion is going to have——

Senator LEVIN. Of the Air Force?

Mr. BOWSHER. Of the Air Force is going to have to be either written off or sold at a depressed price to somebody.

Senator LEVIN. Would a good portion be as much as half?

Mr. BOWSHER. Frank, do you have a feel?

Mr. CONAHAN. No. I think one of the difficulties is that we do not have a good stratification of it. It goes back to the fundamental problems of systems to track that kind of information.

Senator LEVIN. I just thought of one quick last question. Are your estimates of the excess inventory based on their evaluations which you say are inflated or on your evaluation?

Mr. BOWSHER. Terry.

Mr. CARNAHAN. Based on Air Force's evaluation.

Senator LEVIN. So when you say that they are inflated, that excess incentory figure then might also be high?

Mr. BOWSHER. Could be.

Senator LEVIN. Thank you.

Chairman GLENN. The excess would be if they had not marked it down.

Mr. BOWSHER. They are still carrying it at full value.

Chairman GLENN. They are still carrying it at full value?

Mr. BOWSHER. The original cost.

Chairman GLENN. Okay, so that is the difference. You mentioned the very distinct possibility of scandal in some of these areas. Is the best guide to potential scandal still the high risk list that we put out some time ago and which Mr. Darman also put out from OMB?

Mr. BOWSHER. That is the best guide, but I think as we have reviewed this report, and now that we have completed this work and if we can do the next one—which I would like to do the Army next, why by then I think we might come back to you with some modifications to that report.

Chairman GLENN. We were into the B–2 a minute ago and I gave the floor to Senator Levin. We discussed some 2,000 changes. Was that a misprint in the paper this morning or is that correct?

Mr. BOWSHER. No, I think that Frank said that that was accurate.

Chairman GLENN. That is accurate?

Mr. CONAHAN. That is an accurate number, yes, sir.

Chairman GLENN. Many of those changes would be just little clamp changes where there is a little minor thing and everyone has to go through an ECP, an engineering change proposal, and all of that. Do you have any feel of how many of these would be major changes, like a wing carry-through structure on a major change on the airplane? What is major/minor on these? Can you break that down?

Mr. CONAHAN. I cannot break it down, but I can say that there are some that you would consider major in there. They are all not very minor ones. There are, I believe, some 20,000 basic drawings. Initially they believed that there would be only something like 8,000 drawings on this airplane, but as they developed it, they found out that they needed 20,000 basic drawings. So that the number of changes are really very high on this airplane.

Chairman GLENN. Are all these changes having to be also put back on planes produced earlier?

Mr. CONAHAN. There will be some of that. At the moment only one plane has been delivered. The remaining development planes will be delivered later this year and early next year. So you do not have the kind of problem as large as it might be.

Chairman GLENN. You are talking about one plane under the LRIP, the low rate initial production; is that correct? What you are talking about does not include the earlier test aircraft?

Mr. CONAHAN. No, I am talking about the earlier test aircraft. Now the ones that are under low rate initial production, they do not come in for another couple of years.

Chairman GLENN. Have you gotten into the reports of over billing at Northrup that the FBI is supposedly looking into?

Mr. CONAHAN. No, for the reason that investigation is underway and we do not want in any way to hamper it.

Chairman GLENN. You are not involved with that?

Mr. CONAHAN. No, sir.

Chairman GLENN. Mr. Bowsher, on page 18 of your testimony, in the middle of the page, you talk about the Air Force finance officials estimate that several billions of dollars of expenditures were for classified assets which are not recorded in the accounting system for security reasons. While they did not specify the amounts for the remaining expenditures, they agreed that they represent assets that are recorded in the accounting systems at different costs than actually incurred. How does that come about?

Mr. BOWSHER. It comes about basically the same way as the other. In other words, not all of the data is getting into the accounting system and so I would say the problems we found—like the difference between the $14 billion and the $21 billion and the B–1 bomber could be the same on say a black program.

Chairman GLENN. How about the other things that you mentioned—Government furnished materials provided the contractors and consumed inventories?

Mr. BOWSHER. I think that is very important. In other words, I think we have billions out there that should be properly accounted for. As I say the Defense Department has finally agreed to a reporting system by the contractors, but it is all unverified data that is coming in. And the contractors might well have a good accounting and some might not. We are not even sure all the contractors are reporting on it. So I think this is a very important area. We have been stressing this for quite a few years and they have had plans to do something, but I would sure hope that those plans would go forward.

Chairman GLENN. How long did it take you to run this investigation?

Mr. BOWSHER. A little over 2 years. Let me just check, Terry?

Mr. CARNAHAN. Yes.

Mr. BOWSHER. Terry here has been the man in charge and has worked on it for 2 years.

Chairman GLENN. How about the other investigation of the Army and the Navy and so on. Are there concurrently running now?

Mr. BOWSHER. No.

Chairman GLENN. Or are these to be serial investigations?

Mr. BOWSHER. We were going to do them serial because of the large effort involved and we have not started either of them, but we do hope to get started here shortly with the Army.

Chairman GLENN. Do you have any date for that? Do you have an estimate as to how long that will take?

Mr. BOWSHER. I would hope to do that faster than we have done this one. This was our first one of the three big military services. So I would hope that we have got quite a few lessons learned here

and how to audit the military services on an overall basis, and I would hope we could do that a little more efficiently.

Chairman GLENN. Do you have enough people or resources that you could do the rest of the services concurrently. In other words, if we keep up at the rate we are going, as long as this one took and I know that you got into more time than you thought it was going to take.

Mr. BOWSHER. Yes.

Chairman GLENN. I know you do not have unlimited resources, but do you have enough people that we can run concurrent; otherwise we are not going to have the final answer on the last service for another 5 or 6 years?

Mr. BOWSHER. You have just made my friend on the left, Don Chapin very nervous here because I have been pushing him. The State Department wanted an audit on their property overseas. Since the HUD audit, we have everybody's attention here, as the fact that we might well have real problems in some of these areas. So we have a lot of people who are requesting audits, and for the first time working very cooperatively with us. We will have to go back and take a look. If I could get some people out of some other departments at GAO, I might be able to do it. But right now, he is going to shake his head no, and I understand why he is shaking his head, no.

Chairman GLENN. Coming back to the Air Force specifically, we would like to see the optimal or ideal system that you would also like to see in the Air Force. Is there any estimate of how much it would cost to install such a system?

Mr. BOWSHER. No, I do not think you can make that estimate until, as I say, you have some senior architecture put together by either Treasury or OSD and then ask the Air Force. And we would be happy to review their architecture and what their estimates would be, but I do not think we could come up with a figure. But I would point out we have spent millions and probably billions on these systems. What we have not done is done it right or pulled it together properly.

Chairman GLENN. My time is up, Senator.

Senator COHEN. Thank you, Mr. Chairman. I would like to get back to this issue about the spare parts management, and I agree with what you said in response to Senator Levin about the build-up coming rather rapidly and leading inevitably to waste. I would like to go back to the early 1980's, however, and Senator Glenn may recall this that at the beginning of the Reagan administration, the services were complaining that they had a totally inadquate supply of spare parts; that they were in fact cannibalizing aircraft; that there was a loss of morale on board ships; that they had to cannibalize one aircraft to feed the parts into another; that they could not test various missiles and so forth. So, I think that that attitude also contributed to this build-up.

Mr. BOWSHER. I think that is a fair statement, Senator.

Senator COHEN. It is almost a feeding frenzy. If we do not get it now, it is going to be cut out later. We are going to have the same problem we had back in the late 1970's and buy the parts now.

Mr. BOWSHER. I think that is a very fair description.

Senator COHEN. Coupled with inadquate management, financial management systems contributed to what we have now. We have been involved in this for a long time. Senator Levin and I remember back to the early 1980's. We had a similar problem in dealing with the year-end buying. We finally, as I recall, passed some legislation prohibiting the hurry-up spending, so that they had to really structure the spending so it would go out on a quarterly basis and not load it up at the least 3 weeks of the end of the fiscal year when they would suddenly unload their entire budget.

So it has been a catch-up process on the part of Congress for much of this, but it brings me to the point—has there been any analysis? You know, it is easy for us to sit up here and start condemning the Administration and we do it frequently. But what has been the role in Congress in all of this? We tend to pontificate and say, "Is this not a terrible thing and it is, but what role have individual members of congress played in assisting the purchase of either weapons systems or spare parts that were totally unnecessary, uncalled for, not requested, and funded over the objection of the DOD? Have you made an analysis of that?"

Mr. BOWSHER. We have not made that specific analysis, but we have looked at various weapons systems from time to time and I understand what you are saying there. I remember many times the services were forced to continue lines on the planes. I remember building 87's back there in Fort Worth, Texas, at practically one a month or three a month or something like that. So we have had a history of that and that is a very costly way to——

Senator COHEN. I just want to make the point that while we are up here hurling stones, that in a number of cases, members of the Senate and the House have been the ones who have been responsible in forcing the DOD to purchase systems which are totally unnecessary. We ought not to forget that, as we are starting to condemn past administrations.

Mr. BOWSHER. If I could pick up on your point too, Senator, and that is, that after the HUD audit where we ran into, of course, many many problems and reported on that, I have been asked by many Senators in Congress, how can Congress improve its role on this oversight. And I think one of the key things is to get an annual hearing with the agencies, an annual report, a financial audit. In other words, some basic overall management has to be put in place and then reported properly to the Congress.

And the Congress has to ask tough questions. In other words, why do you not have the system for Government furnished material? You told us 2 years ago you were going to have it in this year and things like that. That is the kind of oversight that I think we need.

Senator COHEN. Did your analysis come to any conclusions in terms of this tremendous excess of spare parts. Did you make any analysis in terms of what the misallocation might have been? For instance, do we have too much of one thing and not enough of another?

Mr. BOWSHER. Yes, we have done some of those inventory studies separate from this. It was not included as part of this study.

Senator COHEN. Could we get a copy of those?

Mr. BOWSHER. Yes, absolutely.[1]

Senator COHEN. Can you identify those agencies that have good accounting systems for me?

Mr. BOWSHER. Well see, as I point out that we had such a deterioration here in the late 1970's and early 1980's, every one of them today when they answer the question on their financial integrity report, say they do not conform to the thing. Now I think some of the ones that are making progress are the ones that we have done audits with.

Senator COHEN. You would not include HUD in that?

Mr. BOWSHER. No, but I think Jack Kemp is moving out and I think that I would be willing to go out on this limb and say that I would say in 2 or 3 years, HUD might have one of the better systems.

Senator COHEN. How about HHS?

Mr. BOWSHER. HHS is one that we have done some work with and I am not sure, and they have never been in conformity. The two big folks that were never in conformity with the standards were Defense and HHS.

Senator COHEN. How about DOE?

Mr. BOWSHER. DOE does not make them?

Senator COHEN. Tell me who does?

Mr. BOWSHER. All right. The Veterans Administration, Agriculture, Labor and Social Security are making some good strides, as is GSA.

Senator COHEN. Can we look to those as some examples which we can, perhaps, extrapolate their experience to try to come to some system that we can legislate. You said that we have to legislate a system.

Mr. BOWSHER. I do not think you want to legislate a system. What you want to do is legislate an organization and a process, and we have been talking with your staff on that legislation. And I think if some legislation like that was passed, then I think you would get all of them moving in the right direction and I would think you would end up with some good results.

Senator COHEN. Have you made an investigation as to how this draft report ended up in the Washington Post?

Mr. BOWSHER. Yes, I can tell you that. I have not made any investigation, but I think some people in the Air Force leaked it to some people on Congressman Dingell's staff and from there somehow it went to the Post.

Chairman GLENN. And the Times.

Senator COHEN. Did someone from the Air Force leak it deliberately to Congressman Dingell's staff?

Mr. BOWSHER. That is my best guess.

Senator COHEN. Was it to enhance the position of the Air Force?

Mr. BOWSHER. I am no sure what the motivation was. That is about all I know.

Senator COHEN. In other words, do you think that there are people within the Air Force who are critical of the Air Force management problem that wanted to get this out early?

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[1] The reports referred to may be found in the Committee files.

Mr. BOWSHER. I think that could be a possibility. We apologize to you for not being able to bring to you in an orderly fashion. We were planning to do it.

Chairman GLENN. You have stated your desire here today that GAO wants to go ahead with an audit of the Army and Navy and anybody else in DOD also, and I certainly support that. I would like you to do that, but also I would like to have you report the results to this Committee as soon as the audits are completed. Can we count on that?

Mr. BOWSHER. Yes.

Chairman GLENN. Good. Thank you.

Mr. BOWSHER. Mr. Chairman, if I could ask Don Chapin here to just say a few words about the short-term efforts that we think the Air Force should pursue too here with some of these problems.

Chairman GLENN. Fine, go ahead.

Mr. CHAPIN. We have had a good discussion of the findings in our report. We have not really dealt with the recommendations. I would point out that the Department of Defense does agree or partially agree with all of those recommendations. And what they provide is a road map for the Air Force to clean up and improve its existing systems. And I think that is fundamentally important and urgent.

Beyond that our report points out an approach that should be taken to systems development. That also is very important. We must not divert attention from neded improvements and look ahead to some grandiose system that 5 years from now will answer all of our problems. We have some blocking and tackling to do with double entry accounting systems, with ordinary things like reconiling accounts, brush checking. The ordinary stuff that every business is able to accomplish.

I think with good strong effort by the Air Force that much progress can be made and much better accounting can be done in the short term. And I think that is very very important. Also I think that we must keep our eyes on the fact that what we have learned over case after case that systems development has to be incremental. We have to move from where we are slowly forward, gradually forward, and gradually improve our systems. The worse thing that we could do at the present time is to say the Air Force is all messed up; let us forget about it let us develop the long-range plan; and let us some how or other 5 years from now solve this problem.

Senator, we need to solve the problem in the short term and it can be done if the Air Force really puts its mind to it and we get support from DOD and of course help from GAO.

Chairman GLENN. It is a little hard to conclude anything but that they are all fouled up. We are talking about tens of billions of dollars and $2 trillion off over a period of time. These are terrible large figures.

Mr. CHAPIN. I realize that we have a very very serious problems, but we can do a lot to deal with that problem by doing some short range things as pointed out in our recommendations.

Chairman GLENN. I am not an accountant obviously, but how much are you talking about? Are they talking about a completely different philosophy of accounting?

Mr. BOWSHER. I do not think it is a different philosophy of accounting. What it is is an emphasis on reporting back on what is known as fund control and namely the budget appropriations. As you point out in your early opening statement, Mr. Chairman, you have got 90 billions of appropriations to the Air Force, but you have got $270 billion of assets. What we are saying is you have got to have an accounting system that tells you where things stand on those $270 billion, not just on how much money the Congress appropriated this past year.

Chairman GLENN. Is this, in effect, going to a capital accounting system which the Federal Government itself has never had?

Mr. BOWSHER. No, this is not forcing a capital budgeting system or capital accounting. What it would say though is that you have got to account for your inventories and your capital assets which has been part of the standards for some time. But you would not be changing the budgeting system.

Chairman GLENN. So you know what you have?

Mr. BOWSHER. That is right.

Chairman GLENN. How fast do you think this could be corrected to an acceptable level?

Mr. BOWSHER. I think as Don points out here, Mr. Chapin, that I think a lot of progress could be made in a year or two in just doing basic things properly. In other words, closing up the books right and make sure the information is flowing properly, reconciling the accounts, looking at numbers that do not look right, and seeing what is wrong with them before you make adjustments, and basic things like that.

Then I would say that you have the longer term problem of getting some of the systems in and that might take more than 2 years, but I certainly think that in 3 or 4 or 5 years, you should have it accomplished.

Chairman GLENN. How much is it going to cost us to find out what the costs are?

Mr. BOWSHER. You have to do that architecture. You have to do that overall approach before you can come up with a good figure.

Chairman GLENN. Senator Cohen was pointing out our difficulties in past years where we were the ones screaming about why we did not have enough spare parts. But there should have been some balance to assure that you do not over procure. But I do recall at that time we had carriers going back and forth to the Persian Gulf and having to cross-deck missiles because we did not have enough spare parts. And as one carrier relieved another one on-station, we had to take missiles off the airplanes coming back to the States and put them on the other ship. We did not have enough of them and part of that problem was spare parts.

Now, I do not know what our missile spare parts are at this particular point, whether we over procure or not.

Mr. BOWSHER. But you know, Mr Chairman, I think this report points out—a lot of people say what would you do with this financial information? But one of the things that we did not buy, even though we spent as much money as we did in the 1980's, but we have a fair amount of shortfall and we have reported on this on some of the costly missiles and torpedoes in the inventory today, not spare parts, but some of those weapons themselves.

Those could have been bought, if we had not bought all this inventory that is not needed. In other words, you really have a trade-off here of readiness when you misuse money to buy things that you are just not going to need. So today as much as we spent in the 1980's, we do have some problems on some of those weapons.

Chairman GLENN. Don Rice took considerable exception. The Secretary of the Air Force took exception. Let me run through his letter, pick out a couple of points, and see what your response is to it.[1]

Mr. BOWSHER. Sure.

Chairman GLENN. One of the first points he makes is that you have a GAO pre-conceived accounting requirement that has not been promulgated to the Executive Branch or approved by OMB and that they should not be treated as a for-profit company, and that this concept that you are putting forward has not been accepted by Congress or the Executive Branch.

Mr. BOWSHER. We put this core financial system out. This was a letter that Jim Baker, Secretary-Treasurer, Jim Miller, OMB, and I signed in 1986 saying that we needed a stand. I will just read it here.

It says here, "The purpose of this memorandum is to convey the top level commitment of the three central financial agencies to major improvement in Federal financial management. To manage resources within future deficit reduction targets, we will need better financial information." And we go down in there.

Then we put 2 years later, signed by again the three financial executives and I might say it is the same three people, Baker, Miller and Bowsher. That here is a memorandum for heads of all departments and everything like that, and so when we audited, we audited against existing standards. Not against private sector. We often get a charge, you know, that what we are trying to force here is private sector accounting. What we are auditing here is against the standards of the Federal Government which have been put out by the OMB and the Treasury.

Chairman GLENN. His statement was that you are auditing to "GAO preconceived accounting statement requirements that have not been promulgated for Executive Branch adoption by the OMB." You take exception to that?

Mr. BOWSHER. We take exception because in Appendix 2 we go against the statements required by the Treasury and that is where we show all the problems that we had with the individual line item of assets.

Chairman GLENN. The next major point he makes in his letter is that "Basically no cost savings are identified. Implementation costs, likely to be in the billions for DOD, are ignored."

Mr. BOWSHER. It gets back to—I will just take the inventory issue that we have been talking about here. We run up these large inventories. We did not say in this financial audit how we though it could be cut or anything like that. But that is the question that Senator Nunn and some of the others are asking. And I think if you have accurate financial information, you have a much better

[1] See p. 170.

basis for making those management decisions. So I think the savings are there.

It is just like in the civil agencies where we have identified, like the Justice Department, that they are not collecting the fines because they do not have the systems to know what the people owe them. It was the same at HUD and that and I think it is the same in the Air Force and the other services. If you do not have the information, it is hard to point out where some of the potential savings.

Chairman GLENN. The next point he makes is that the draft report offers what he calls "The CPA's view of the information needed for Defense decision-making that has limited relationship to the real problems of Defense management." I think you already addressed this to some extent?

Mr. BOWSHER. That is right.

Chairman GLENN. But he goes on to say, "There is no mention of the Defense planning programming and budgeting system, the SAR (Selected Acquisition Reports), the independent cost analysis process, or the many analytical studies that cost other factors. The report simply does not make a case why I need to know the depreciated cost-base dollar value of the DOD inventory in order to make an informed decision about the need for the B–2." And, I guess, it sums it up in the last sentence, "Even if that information were useful, why do I need it at a penny-wise level of accuracy that a CPA would judge auditable?"

Mr. BOWSHER. In that point, we are not talking about penny accuracy here; we are talking about billions of dollars of errors and I have tried to explain those three systems that the identified there. One has been giving Congress misinformation for a decade literally. It has been of limited value. They cannot even produce it now. That is the 5-year Defense plan. The SAR reports I feel are the best information, but they are not tied to the official records or the accounting records. So we have reported for a number of years the problems with the SAR system.

And on the independent cost estimating, I just feel you need the actual cost eventually to just check out how well you are doing on your cost estimating. So all three systems that he has identified is what I call the front end systems of budget decision making and what you are not identifying here is how has the money been spent? How has it been accounted for, so that you can go back and do some checking on what you were planning.

Chairman GLENN. Secretary Rice makes a point that they have cooperated fully with you and, in return, they got a hyper-critical inflammatory report, and this is going to make it very difficult to secure cooperation in the future is the implication to it. I hope that does not occur.

Mr. BOWSHER. I hope that does not occur and we certainly recognize the cooperation we received from the Air Force. I wish the results had been better that we could have come over here and reported that the Air Force accounting finance systems were in very good shape, and here is the audit and here is where everything stands. But unfortunately, the results were just not that way.

Chairman GLENN. There is one part of the paragraph—in parenthesis—I want your comment on. "At a public meeting, GAO staff

have described intentionally sensationalizing the title of the report to increase its news-making potential."

Mr. BOWSHER. I do not know where that public meeting was or who did it, but I can assure you, Mr. Chairman, that we do not do that and we have changed the title—we call it now the Air Force does not effectively account for billions of dollars of resources. We do not go quite to the issue that he was objecting to. So when we issue a report in draft for their comments, one of the things we are looking for is some advice and that is the advice that we have taken.

In other words, I think we maybe had a title there that could be better described as now describe it. But I can assure you it was not done to sensationalize the report in any way shape or form.

Chairman GLENN. Were they given a short time to respond to this? They have another complaint that they were asked to comment without having the four underlying reports available to them and were given 14 days instead of the normal 30 to respond.

Mr. BOWSHER. That is not completely true. In other words, we went to the Air Force. We said this is going to be a report that could well leak because of the information that is in it. We would like to work on an expedited basis. You have 14 days rather than the normal 30 days. We really got good cooperation from the Air Force in the last day, and we did get the official comments from OSD within the 14 days.

So we were trying to do it because we knew that this report had great newsworthiness and we were trying to speed up everything like that. If Mr. Rice or anybody had officially asked for an extension, we certainly would have considered it. But we would have pointed out, and as the facts have proven to be, that the more they xeroxed this report over at the Pentagon and passed it around, the chances of it leaking were quite high.

Chairman GLENN. He makes a point that their systems of accounting emphasized fund control, making sure spending limits are not exceeded. Expenditures did not exceed appropriations. What you have pointed out this morning is that the proper decisionmaking in Congress and in DOD goes far beyond just that.

Mr. BOWSHER. Far beyond fund control. And I might also point out to the Secretary, and I intend to do this personally, is that he ought to be worried about some of the things that we have identified here as to how accurate his fund control really is. When you cannot reconcile $7 billion of expenditures with your obligations in certain areas, well then you have got some problems there that might come back to haunt you on fund control.

And also one of the things we have learned over the last 20 some years at Defense is that when you are in the period of declining budgets, lots of times you have problems in some of these multiyear appropriations where you have what you hope is enough money to do the work that you are committed for. And we have found in past years some problems in those kind of appropriations. So without adequate systems, it seems to me that the Secretary and his Assistant Secretary for financial management, which is a new person, ought to be very concerned that their systems can give them the information to assure themselves when they certify those fund control reports.

Chairman GLENN. I think you have addressed this, but he notes that "OMB Circular 127 requires that they process financial management data only when necessary to meet specific internal management needs or external requirements, tailor reports to specific user needs, and terminate reports if usage is not justified costs." I do not think any of us quarrel with that.

I think the point you have been making is that financial management, the way they have gone at it, is not designed to accomplish those ends, and we need to do a lot more?

Mr. BOWSHER. That's right. And we were looking at the top Treasury reports and the top financial systems. We did not in any way become critical of the management information system down throughout the Air Force.

Chairman GLENN. The Inspector General weighed in on this too. She was quoted, as I am sure you have seen that, as saying that "In part GAO assumes that better financial systems will automatically lead to better decisions on the selection of the future weapons systems." I think you have already addressed that.

And she says the GAO also ignores the enormous cost of developing these systems. For example, the cost for just one such system—this would be the Army Reserve component automation system, a monitoring system currently in development, has grown from $250 million to over $1.5 billion. Is that correct?

Mr. BOWSHER. Well, we think it might be in the ball park. My point is that is not even a financial system or accounting system. To me that paragraph quoting the IG is one of the most disappointing parts of that letter, because they are the people that are supposed to be worrying about accountability and fraud and waste and abuse, and for them to come out and say that they think we have been over-critical in some of these things; I do not understand that at all.

Chairman GLENN. The IG questions the value of "Capitalization and depreciation of military hardware."

Mr. BOWSHER. In our report that is the old issue that some people try to hang on it, and that is, that we are just pushing for depreciation. What we point out is depreciation of these assets are not officially required at this time, but that we do see some merit in it and things like that. So that is an issue that has to be debated here in the next few years I guess.

Chairman GLENN. There was one final part of the second paragraph of the IG's comments that I did not quite follow, and I wanted to contact them to ask a question about it too, because we have been into this before on this Committee with the long supply items, as you well recall.

Mr. BOWSHER. Yes.

Chairman GLENN. Finally, "Finally, the GAO comments with respect to long supply items and loss of inventory control (a very serious problem both within our own depots and for material in the hands of DOD contractors) have little or nothing to do with financial reporting, since these stocks must be managed on an item/inventory basis for readiness and warfighting purposes—not on the basis of a financial statement."

I do not quite follow that because, to me, the billions and billions of dollars that we have already identified, as long supply items has

gone up from $9 billion for DOD, not just Air Force, but DOD total. As I recall, the charts we had on the wall showed $9 billion in 1980 to $31 billion in 1986. That kind of money affects everything else you do and what else you can buy. So I do not follow that.

Mr. BOWSHER. Absolutely. That goes back to some people who in the military think that if they just have unit record thing that they can manage inventory and they do not need dollar value. But that also means that top officials do not know whether the dollar value is going up, going sideways or going down.

Chairman GLENN. I guess my next question would be what can we rely on over here. On page 3 of your report, you said they do not have accurate—this is in the Executive Summary—they do not have accurate cost data for almost all of their non-cash assets, such as inventory, equipment, aircraft, and missiles, and that these assets, which account for over 70 percent of the assets on its consolidated statement, were unauditable and GAO was, therefore, unable to express an opinion. It goes on to say that the financial information produced and reported to OMB and Treasury is not reliable, in contrast to fund control procedures, that is, making sure spending limits are not exceeded, which generally operate effectively.

The operations area is one that we get into here, but is it operating effectively; however, the other area is one that we are going to be into very very much. Senator Cohen, Senator Levin and myself are all on the Armed Services Committee. Senator Bingaman is also on this Committee. We serve on the other committee, too. We are going to be faced with voting on these things and trying to rely on somebody's information.

How can we do that? What information can we have in considering this year's budget? What sources of information?

Mr. BOWSHER. I think Senator Nunn is trying very hard to get the 5-year Defense planning system, and I think that is essential. I have always thought that if we could get these SAR reports working better——

Chairman GLENN. Basically the FYDP is $2 trillion off over the last several years.

Mr. BOWSHER. That is what it has been. What we are hoping is to get one—but all the indications are that I think you are going to be faced with making the decisions without the fit-up this year—a real fit-up. Frank, do you have any——

Mr. CONAHAN. That is absolutely correct, the Department of Defense has indicated that it does not intend to prepare a full fit-up for this year.

Mr. BOWSHER. So I think you are going to be lacking information this year on some of the key parts, but I would hope that through this Committee and the Armed Services Committee and some of the intiatives that we are working on with you that we could get this changed in the future years.

Chairman GLENN. Would you comment on the point, that when they did not get data, they just substituted data from a different time period?

Mr. BOWSHER. What I was discussing there with Senator Levin, and that is, that you get people down in the organization that recognize that people are not reviewing these carefully up the chain,

and so then they start putting in old data. I can remember that when I did the Washington, D.C. audit 15 years ago, the first time it was ever done, why we found that they were sending in year-old data.

What we have here in the Air Force is they are sending in 6 month old data and it just should not happen. It just should not happen.

Chairman GLENN. You are supposed to receive data, according to this, by the 30th of September. They did not have it in, so as a result, March 31 data was used in lieu of missing September 30 data. Furthermore, over $25 billion of Air Force assets were not included in the financial reports to the Treasury and an additional $10 billion in transactions were counted twice.

Mr. BOWSHER. In other words, it just shows how sloppily the reports were put together and then sent right up the line.

Chairman GLENN. In the Executive Summary, do figures on specific aircraft programs include operational costs that were not used before—not put in before? Were these just procurement costs?

Mr. CARNAHAN. Yes, sir.

Mr. BOWSHER. Where are you reading from, Senator?

Chairman GLENN. I am reading from page 6 of the Executive Summary. It does not have a number on it, but I think it is page 6. It is under "full cost of weapons systems not identified." It starts at the bottom of page 5.

Mr. BOWSHER. It is just procurement. That does not include the operating costs.

Chairman GLENN. Do we have figures for operating costs that indicate similar errors?

Mr. BOWSHER. I believe we do.

Mr. CARNAHAN. We did not get the information on the operating costs during this audit, because they did not accumulate that information.

Mr. CHAPIN. Senator, that is one of the problems with our systems and our accounting. We just do not have that kind of information. That information is lost in the tubules.

Chairman GLENN. How close did they come on their estimates of operating and maintenance costs, things like that? We do not really have figures on those?

Mr. BOWSHER. No, in fact, if you look on page 54 is where we say the operating costs of aircrafts and missiles are not known. And when we say as with acquisition costs, the costs of operating and supporting weapons systems are not accounted for or included in the budget in a way that would allow the cost to be identified with a specific type of weapon system.

So that is when you go for some of the support costs like say for the B–2. To look back at the B–1 it can be pulled together probably in some way of doing work sheets and special studies and that, but the accounting system does not pull it together for you.

Mr. CHAPIN. Senator, one of the fundamental gaps here is the lack of a good cost accounting system. Beyond keeping general ledger records, you must know your costs. And there is no effective cost accounting system in the Air Force. So that is the reason that we do not have such information on operating costs by weapons systems. We just do not have it.

Chairman GLENN. What percent of the overall cost of a weapons system—and I know this would have to be broken down from one type system to another—what percent of these systems' costs would be taken up by Government furnished material or equipment?

Mr. BOWSHER. It would vary by the individual.

Chairman GLENN. Missiles would be one thing; for aircraft it would be another; for something else——

Mr. BOWSHER. Even when you have aircraft sometimes the engines are done through Government furnished material and sometimes they are not. But generally speaking the Government furnished material of any major weapon is pretty high percentage.

Chairman GLENN. Do you have a figure? Is it 20 percent on an average or 25 percent?

Mr. BOWSHER. We do not have a figure, but those percentages are not unreasonable.

Chairman GLENN. Those were not included at all?

Mr. BOWSHER. No.

Chairman GLENN. And not accounted for.

Mr. CHAPIN. And not accounted for.

Chairman GLENN. This addresses something that we got into with the Navy some time ago, that is, sending material for overhaul or rework to the contractor and not keeping a record of it.

Mr. CHAPIN. Right.

Mr. BOWSHER. I think we have even this year——

Chairman GLENN. You just hope that the whole thing comes back some time, but nobody really knows for sure. Is that what you found to be a pattern here too?

Mr. BOWSHER. I think in other reports—Frank, correct me if I am wrong—but I think we have issued reports where sometimes we have got double billing for the same GFM; is that right?

Mr. CONAHAN. Yes, correct. Both of those problems have been reported. We will get into some of these, Mr. Chairman, in early March before you.

Chairman GLENN. That is a hearing we are supposed to have on that specific area, but those figures were not even included in here then?

Mr. BOWSHER. No, in other words, that is not part of the accounting system in the Air Force.

Chairman GLENN. Do you have a feel for this lack of an accounting system? How much of this inventory then turns up missing?

Mr. BOWSHER. I do not think we would have an overall figure, no.

Mr. CHAPIN That is one of the unknowns. It is another fundamental one. When you do not have good records, you cannot tell what is missing.

Chairman GLENN. It is one thing for big items like engines or a major component that people cannot just shuffle around, but does the same thing happen for small items that could be put in your pocket or put on your back and carried out?

Mr. BOWSHER. I am sure that some of that is included, but we do not have any idea.

Chairman GLENN. In your report, you make recommendations to their chief financial officer. Who is their chief, financial officer? That is what we are trying to establish across Government.

Mr. BOWSHER. You have had kind of an unique history in the Air Force. You had an assistant secretary for financial management, and then when you had the Goldwater/Nichols legislation why the Air Force was the one service that eliminated the civilian assistant secretary. Then the Congress voted legislation that would require, so they do have a new assistant secretary. I think he has only been in office just a few months.

Mr. CHAPIN. Six months.

Mr. BOWSHER. Six months maybe. So you had a general who was in charge. I might say though that General Watts who was the Comptroller when we started this audit was very cooperative. In other words, we have no complaints at all with General Watts willingness to do an audit to try to put these financial statements together. But I think that you have just not had the investment in the systems and in the financial reporting that we need. And I think the new assistant secretary should be charged with getting this program in shape.

Chairman GLENN. I believe that on all of your recommendations, there was either concurrence or partial concurrence, but not a denial on any one of them.

Mr. BOWSHER. That is correct.

Chairman GLENN. That is from the comptroller's shop of the Defense Department. You did have a letter from the Secretary of Air Force that raised his concerns.

Mr. BOWSHER. Yes.

Chairman GLENN. Let me go back to some of those recommendations.

Recommedation No. 8: GAO recommended that the secretary of the Air Force direct his Chief Financial Officer to accumulate and report actual costs of equipment in accordance with Title 2.

DOD response: Partially concur. A Defense management report initiative provides for the development of the DOD-wide financial management functional requirements.

Question: Are those going to be in place when you monitor or you audit the Army and the Navy and Marine Corps and everybody else?

Mr. BOWSHER. We are not sure. Until we do the audit, we——

Chairman GLENN. Are they moving to do that now? Do you know?

Mr. CHAPIN. All we have at the moment is the general statement that we have all seen on the intent of DOD to move to new and a better and improved management system.

Chairman GLENN. But you have no inside information that they are moving in that direction yet?

Mr. CHAPIN. We do not know the specifics of what they intend to do.

Mr. CONAHAN. No, but I think it is fair to say that the services have been charged with implementing plans for that and that they are working on them.

Chairman GLENN [reading].

Recommendation No. 16: The GAO recommended that the Secretary of the Air Force direct the Chief Financial Officer to accumulate and report actual costs of weapons systems, which include acquisition costs, Government furnished material, operating and maintenance costs, and modifications.

DOD response: Concur. Appropriate action will be initiated consistent with Executive Branch requirements. It should be noted, however—and this is what got my attention—that the cost data required to meet Congressional requirements for Air Force weapons systems is currently being obtained from sources other than the asset accounts in the Air Force accounting system.

Who is supplying that information, if the Air Force does not? Are we just using contractor data?

Mr. BOWSHER. I am sure part of it is contractor data. In other words, and that is my concern as I explained to Senator Cohen about the SAR reports not being routed in the accounting system. In other words, I think that we have been relying on a system here that each program office puts together the information from various sources.

Sometimes I think they come up with fairly accurate reports, but sometimes they do not. So I think that although they point out here that they have been issuing statements from various sources, I think that very statement there should give you concern as it obviously has.

Chairman GLENN. It does. That is the reason I was reading it in the middle of the night last night. It jumped out at me even at that time. We are relying on non-Air Force data as a basis to appropriate, I guess. Is that right?

Mr. BOWSHER. And see some of the future data that would be in those reports probably would have to come from the contractor and that, but how much has been spent to date should come out of your accounting system.

Chairman GLENN. Maybe their response was just too rapid, but it does not say partially or anything else. It says, "should be noted, however, that the cost data required to meet Congressional requirements for the Air Force weapons systems is currently being obtained from sources other than the asset accounts in the Air Force accounting system." That would mean the complete figures that we are going to get in the budget are not really vouched for by the Air Force are they? Do they check them out at the contractors? What do they do?

Mr. BOWSHER. I think if each program office pulls together that report and the best information that they have and they send it up the line and it comes over to you, and as we have reviewed them over the years, we have found a mixture of accuracy and timeliness.

I think one of the problems we have always had in some of the SAR reports is that the problems and the cost over runs get reported late. So one of the things I have always said is let us get at least the cost to date coming from the official accounting records. It has never been accomplished.

Chairman GLENN. Recommendation 17 is basically the same thing. They point out that same thing again in their answer. Recommendation 17 was stating Recommendation 16 a little differently. It said,

The GAO recommended that the Secretary of the Air Force direct the CFO to report actual and planned cost data to the Congress so better decisions can be made on program funding.

That is exactly what we are dealing with in the budget. That is what we have to vote on. It is starting after our hearings in a

couple of weeks. That is what we have to vote on and their response to that once again is:

The data required by the Congress will be provided. As noted in response to Recommendation 16, however, applicable data from sources other than the Air Force asset accounts are being used to provide the Congress with required data.

If they are not willing to substantiate it or stand behind the figures when they come over here, are we just to presume that this is Northup or Rockwell or Boeing or somebody's else data that we are looking at? Do you know?

Mr. BOWSHER. I am sure that some portion of the data comes from other Air Force records, but I would suspect some portion comes from contractor records.

Chairman GLENN. The one on Recommendation 19, I had marked that one too.

The GAO recommended that the Secretary of the Air Force direct the CFO to establish and implement procedures to identify and record in the accounting records equipment paid for and accepted by the Air Force but held by contractors.

You made a point of that in your report. And in DOD's response is, they concur.

The Department has taken steps, as part of the DMR to correct this Air Force deficiency. One of the Department's initiatives involves developing a DOD-wide standard accounting module to record the cost of Government property in the hands of DOD contractors.

Have you gotten into that one in any more detail?

Mr. BOWSHER. No, we have not, Mr. Chairman.

Mr. CHAPIN. It seemed to be a responsive comment.

Mr. BOWSHER. Yes, in other words, they seem to be agreeing with us here, but I think their initiative is still here in trying to develop their overall standard.

Chairman GLENN. Recommendation 22 deals with this $18 billion of inventory in excess of strategic requirements. And their response was, they partially concur.

The Department does not agree that the $18 billion referred to by the GAO is excess to strategic requirements. The Department has recognized that the large value of inventories requires appropriate action. The DOD acquisition officials have initiated actions to improve inventory management through the Defense Management Report initiatives.

Do you have any more detail on what they are doing with that DMR initiative?

Mr. CHAPIN. Senator, I would like to point out that the $18 billion was in the draft report and subsequently was changed to the $10 billion that we have been talking about this morning. So $10 billion——

Chairman GLENN. So the correct amount is $10 billion?

Mr. CHAPIN. I believe that must be the exception they are taking here.

Chairman GLENN. Okay, that is still not an amount we want to ignore—$10 billion is $10 billion. I think we have about exhausted the main points this morning. I have obviously, with the paper clips I have put on these last night, questions on about 50 additional pages here—not quite 50, but 25 or 30. I may want to submit some of those to you. Some of them are more detailed.

Mr. BOWSHER. Sure, we would be pleased to answer any questions.

Chairman GLENN. But I think we have hit the main points and I think you have done yeoman's service on this. The Air Force obviously thinks you went a little overboard on it. But we look forward to hearing the Air Force's response to this at a hearing at an early date. I am sorry they could not be here today, but I understand that, with something this detailed, perhaps they needed a little bit more time. So I am not overly critical of them on that.

As you get into these other audits of the other services, I would hope that we could be kept apprised of things as you go along. I know that is difficult to do. But our problem here is we cannot put off our voting on appropriations and authorizations for a 2 or 3 year period while we accomplish some of these things, and we need some advice as we go along.

Mr. BOWSHER. We will try to keep you informed.

Chairman GLENN. Keep us as informed as you can and we hope the leaks do not occur in the future, but that is one of the Washongton's problems. We appreciate your being here this morning, and thank you very, very much. It has been very illuminating, and I am sure that some of the other members could not be here this morning because there are no votes today and it is Friday. We did not have quite the attendance that we might otherwise of had.

But I am sure there will be other questions as staffs brief their Senators on what happened this morning. So there may be additional questions that we want you to provide answers to for the record.

We appreciate very much your being here this morning. We will stand in recess, subject to the call of the Chair.

[Whereupon, at 11:49 a.m., the Committee adjourned, subject to the call of the Chair.]

APPENDIX

United States General Accounting Office

GAO Testimony

For Release
on Delivery
9:30 a.m. EST
Friday
February 23,
1990

Financial Audit: Air Force Does Not Effectively Account for Billions of Dollars of Resources

Statement of
Charles A. Bowsher
Comptroller General of the United States

Before the
Committee on Governmental Affairs
United States Senate

Mr. Chairman and Members of the Committee:

We are pleased to be here today to discuss our recent efforts to audit the Air Force's fiscal year 1988 financial statements. This was the first time that a military service developed financial statements and provided them to GAO for audit. We are releasing our full report on our review to the Committee today, and our testimony will summarize some of the key results. Before discussing our findings, I would like to put into perspective why it is so important now that government agencies - particularly the Defense organizations - take the initiative to establish the kinds of systems, controls, and procedures needed to make them capable of producing acceptable financial statements that can be audited by an independent third party.

Quite simply, the successful preparation of financial statements demonstrates that an organization's systems and personnel are capable of accumulating, analyzing, summarizing and reporting on its financial condition and operating results. This capability has long been demanded by the Federal government for the private sector, and more recently for state and local government sectors as well. More recently, several of the major civil federal agencies have used financial statements as a key element in their efforts to bring financial control, accountability, and cost effectiveness into their operations. These include GSA, the Departments of Veterans Affairs, Agriculture, and Labor, as well as the Social Security Administration. Most recently HUD in reaction

to the scandals in its housing programs, has launched comprehensive initiatives to bring financial integrity to its operations. The development of financial statements for audit represents a cornerstone in HUD's strategy for doing this. However, the taxpayers should not be expected to wait for HUD scandals to occur on a case by case basis to get proper financial and accounting procedures implemented one agency at a time.

In candor, I have to tell you that getting federal organizations to prepare acceptable financial statements is not an easy task. Change does not come easily to federal operations. The federal government has always stressed appropriation accounting and fund control, in other words the budget process. This is certainly a critical part of government financial management; unfortunately in many organizations it may be the only part that is being seriously considered. In such situations, "How much can I spend"? overshadows the equally important question "How well am I managing and controlling the resources I already have?" The latter question becomes even more important for DOD in today's environment of looming reductions to the defense budget. The military services are already responsible for huge amounts of assets, the Air Force alone is entrusted with assets reportedly valued at $275 billion.

Similarly, today's environment will require greater emphasis on costs and how to control them. We have found that federal agencies' accounting systems do not routinely accumulate and report

on the costs associated with their various operations.

Meaningful cost control requires knowing first what the costs being incurred are. Unfortunately, many federal agencies do not have accounting systems to provide this information in a systematic manner. Until they do, meaningful efforts to control costs and achieve financial efficiency cannot take place.

AIR FORCE FINANCIAL
SYSTEM DO NOT PROVIDE
RELIABLE FINANCIAL DATA

Specifically with regard to the Air Force, our audit noted that its accounting systems do not provide accurate cost data for almost 80 percent of its non-cash resources such as weapons, inventory, and equipment. Its accounting and financial management systems can neither provide complete and reliable financial data nor be depended upon to report accurately on the resources entrusted to its managers. Much information that is produced is not timely. Financial reports can only be developed with extensive, time-consuming efforts to compile data from a variety of sources. These conditions adversely affected financial reporting and management at all levels, ranging from the Air Force consolidated financial statements down to base level financial reports.

The General Accounting and Finance System was intended to serve as the Air Force's general ledger, but a number of very significant accounts were not included. Certain data, such as aircraft values ($82 billion) and accounts payable amounts ($18 billion) had to be derived from property systems or from extracts of budgetary data rather than from a properly designed financial management system. In short, the Air Force does not have basic double entry accounting control over the bulk of its assets.

One result of these conditions is that financial reports to the Office of Management and Budget and the Treasury are also inaccurate and unreliable. In recent years some Air Force components failed to submit financial data in time to be included in the year-end Treasury reports. As a result, March 31 data was used in lieu of missing September 30 data. Furthermore, over $25 billion of Air Force assets were not included in financial reports to the Treasury and an additional $10 billion in transactions were counted twice.

Use of even the limited existing financial reports within the Air Force was quite limited. Analysis of the accounts used in preparing the financial reports showed obvious errors that were not corrected and were not investigated to determine if a problem existed. As a minimum, obvious mistakes and significant changes in account balances should be followed up to make sure that serious problems are addressed. Some examples of accounts that warranted

further review are:

-- The disbursement accounts at the Air Force Systems Command declined by 64 percent between fiscal year 1987 and 1988. This could indicate that information is not being properly reported by payment centers or the rate of progress payments is slowing. Management needs to monitor the contracts more closely based on this data. The same account decreased at the Aeronautical Systems Division by 97 percent, but increased at the Rome Air Development Center. For the same account, another component--the Space Systems Division--reported a zero account balance at the end of the fiscal year. Obviously, the Command needed to followup on the activity in this account to determine the abnormal changes and reporting by its components.

-- Air bases reported credit (negative) balances of some inventory accounts and construction-in-progress accounts. Yet management did not investigate the cause of these obvious incorrect balances.

We also found that billions of dollars in adjustments were made which could not be supported or explained by Air Force officials. There can be legitimate and necessary purpose for adjustments. However, without adequate safeguards, adjustments

can also be used improperly to cover up defalcations, hide losses, or mask errors. Examples of improper adjustments and lack of reconciliations were:

-- The Space Systems Division's trial balance for March 31, 1988 differed from its subsidiary records by $2.4 billion. In order to get the two systems to agree, they "plugged" the accounts. In order words, they made an unsupported adjustment for $2.4 billion without finding out why the records did not agree. As a result, accountability was lost and the opportunity to deal with possible instances of mismanagement, fraud, or abuse was missed.

-- Similarly, at the Systems Command, our audit tests disclosed unsupported adjustments of $500,000 that were made to obligation and expenditure accounts for Operations and Maintenance appropriations in September 1988. Officials could not explain the adjustments, nor could they find any documentation to show why they were made.

-- At Sembach Air Force Base, we found that over $214,000 in undocumented adjustments, a material amount for an air base, were made to force control accounts to agree with subsidiary records. When we researched these adjustments, we found that some of the unsupported adjustments were attributed to the actions of a disgruntled employee in the

finance office who failed to properly process transactions, entered erroneous data, and destroyed source documents.

-- At three ALCs, the interfaces between the perpetual inventory tracking systems and inventory accounting system did not function properly. As a result, the two systems reported different amounts on hand for the same items. To compensate, either each month or each quarter, the ALC's accounting and finance office adjusted the accounts in the inventory accounting system to force them to agree with the perpetual inventory tracking system's balances. However, the discrepancies between the systems were not researched to determine their causes. The net effect of such adjustments for fiscal year 1988 decreased the inventory accounts by about $361 million. At our request, Ogden ALC officials researched $241 million of its September 30, 1988, adjustments and found that $114 million was the result of inventory system errors, while $127 million resulted from coding and timing errors. These errors had been masked by the improper adjustments and would not likely have been detected had we not asked base officials to investigate.

FULL COSTS OF WEAPON SYSTEMS
NOT ACCUMULATED AND REPORTED

The development and acquisition of weapon systems represents a major fiscal commitment for DOD and the taxpayers. One of the greatest challenges facing DOD today is to manage reduced spending after a period of large peacetime defense buildup. Since the mid 1980s, DOD's five year defense planning has been fiscally unrealistic. More weapons were being planned and developed than could be produced in an economic manner or supported once they were produced. Since 1982, DOD five-year spending plans have exceeded actual and current estimated funding by over $2 trillion. This is not an effective way for DOD to manage nor does it facilitate congressional oversight of the defense budget.

The Air Force's costs of weapon systems reported in the accounting system are vastly understated. Aircraft, missiles, and engines are valued at an estimated standard or purported "average acquisition" costs which do not reflect actual costs incurred to acquire the items. We compared the accounting system costs to Selected Acquisition Reports (SARs) reports and to expenditures from the budgetary reports and found that actual costs are not recorded in the accounting systems. For example, the B-1B bomber is recorded in the accounting system at $150 million each. The SARs reported $215 million for each and we estimated $219 million each. While the SARs costs more closely approximated

our estimate of actual costs, we have previously reported that the SARs do not adequately disclose all costs associated with major weapon systems. For example, SARs often do not include actual contractor costs incurred to date or a schedule comparing funded quantities to planned and actual contractor deliveries. The SARs also do not reflect anticipated, but not yet approved, cost estimate changes.

The SARs costs are derived from Air Force budgetary data, as are other documents the Air Force uses to portray weapons systems cost. However, OMB Circular A-127 requires that budgeting and accounting should be done on the same basis through integrated budgeting and accounting systems. Cost information, whether reported in general ledger accounts and financial reports or SARs should be consistent. There should not be a variety of different numbers for similar items to choose from.

Other costs that were not included in the weapons systems valuations are:

-- Government furnished materials, such as parts, components, assemblies and raw materials, provided to contractors and incorporated into the weapon systems are not included in the value of the end items. We have previously reported that long-standing problems in controlling and accounting for government furnished materials preclude DOD from

knowing the exact amount of these items in contractors' hands. DOD and the services have no overall management or financial systems to independently verify contractor records and measure the value of government furnished material ultimately included in end items.

-- Over $25 billion of modifications which enhance the mission capabilities and/or extend the service life of weapon systems generally are not included in the valuation of the assets.

Additionally, the Air Force accounting systems do not capture all operating and support costs associated with weapon systems. In 1987 the Senate Committee on Appropriations expressed its concern over the long-term implications of procuring weapon systems which have increasingly expensive operating and support costs. During that same year we attempted to review such costs but were forced to terminate the review because the needed cost data was simply not available. There is no logical reason in today's world that a large, complex organization such as the Air Force should not have a sound cost accounting system. This is absolutely essential for measuring costs and improving efficiency.

INVENTORY SYSTEMS DO NOT PROVIDE ACCURATE DATA

Inventory management for the Air Force is an extremely complex task due to the size of its operations, frequent technological obsolescence, and decentralization of storage for national security reasons. To maintain and support its operations and weapons systems, the Air Force manages about 1.6 million different spare parts and supply items valued at about $64 billion. This is about eight times larger than the inventories reported by General Motors. Unfortunately, systems used to track and value these immense inventories do not maintain accurate data supporting either the quantities or values. Yet these are the systems upon which managers must depend upon in determining whether new items need to be purchased. Using inaccurate information to base purchase decisions can result in unnecessary procurements and excess inventories in some instances, and shortages in others.

Excess Inventories are Increasing

Unrequired inventories have grown tremendously in the 1980s. The Air Force is estimated to have at least $10 billion of unrequired inventory. The growth in unrequired inventory is related to several factors. The most common causes of this growth are overestimated use rates and modifications of aircraft

and equipment. Other causes include faster than expected phase-outs of older aircraft, fluctuating war reserve and safety level requirements, improved item reliability, and items being reclassified as repairable. Also, orders for items in excess of requirements were not terminated and procurement lead times were overestimated. This problem is not Air Force specific, the amount of excess inventory in the Department of Defense as a whole is estimated at $29 billion. We currently have ongoing work that will address matters related to inventory on a DOD-wide basis.

Inadequate Accountability Precludes
Effective Inventory Management

Accountability systems used to track the location and quantities of over half the Air Force's inventory items do not provide reliable, accurate inventory data to managers. Inaccurate inventory records can cause critical supply shortages, prolonged delays in filling requisitions, or unnecessary procurements resulting in accumulation of excess inventory. Although the Air Force has recently improved the accuracy of its data in automated perpetual inventory systems and generally takes accurate physical inventory counts, we believe the perpetual records are still too unreliable to make effective and efficient decisions.

Inventory Valuations
are Inaccurate

The Air Force did not consistently apply its inventory pricing policies to value inventories of investment items. The Air Force assigns values to inventories of spare parts and supplies based on the item's latest acquisition cost. Basically, the Air Force multiplies this cost times the number of units in stock to arrive at the total inventory value. Air Force policy states that the standard price generally represents the last acquisition cost of an inventory item plus a surcharge for government furnished materials and transportation costs. Therefore, all items of a particular stock number are valued at the same price.

Under this practice when items are purchased at higher prices, the value of all such items are adjusted upward. Unless the accounting statements reflect such increases as occurring from changes in valuation, they are misleading because the readers cannot readily determine whether the growth represents an increase in items on hand or simply increased values of current stock.

Inventory Values are Not
Adjusted for Condition

Inventory values are not adjusted to reflect the condition of the items in inventory. Although about $7 billion of the inventory items at the three ALC's we visited were unserviceable, they were valued the same as new inventory items. This practice results in a significant overstatement of inventory values and is misleading because (1) the true inventory value is less than shown and (2) there is a substantial additional cost to bring unserviceable items to an usable condition.

The military services maintain a large number of unserviceable items in their inventories for a variety of reasons. For example, components that are very expensive to repair and not in high demand can be better controlled and scheduled for repair only when needed. The Air Force has determined that it is more efficient to maintain the unusable item under normal inventory control and repair it when necessary. Although this approach may be effective for certain inventory management purposes, it is not acceptable for financial reporting purposes. To show these items at the same value as fully serviceable items, when many require the investment of significant dollars before they can be used, distorts the financial statements. The Air Force needs to develop a methodology to regularly adjust the unserviceable portion of its

inventory to reflect costs associated with repairing the items.

FINANCIAL STATEMENTS AND
AUDITS SHOULD BE REQUIRED
FOR ALL FEDERAL AGENCIES

The Air Force audit illustrates why we do need reliable financial statements for federal agencies. There are still some who insist that traditional federal financial management practices are adequate and that financial statements and audits are not needed in federal operations. I would like to put these notions to rest.

Almost universally, our financial audits of civil agencies, as well as the Air Force, have revealed systems problems which are so severe that the financial information needed to manage agency operations as well as prepare agency financial statements are seriously deficient. These problems are generally more serious and deep-seated than either we or the agency managers realized before the audit. We believe the process of trying to prepare financial statements forces full recognition of the systems problems. The process is like an early warning system, an often overlooked value which derives from the preparation of agency financial statements.

United States General Accounting Office

GAO

Report to the Congress

February 1990

FINANCIAL AUDIT

Air Force Does Not Effectively Account for Billions of Dollars of Resources

Printed copies of this document will be available shortly.

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United States
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Comptroller General
of the United States

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February 23, 1990

To the President of the Senate and the
Speaker of the House of Representatives

This report presents the results of our review of the Air Force's financial management operations and its efforts to prepare consolidated financial statements. While the financial statements, included as appendix I, purport to show the Air Force's financial position and results of operations for fiscal year 1988, our audit work demonstrates that the Air Force does not have accurate cost data for almost all of its non-cash assets.

Air Force managers are accountable for $275 billion in weapons systems, inventories, and other assets and for annual appropriations of over $90 billion. However, the Air Force's financial management systems and internal controls are not sufficient to provide adequate and reliable financial information for effective management of the Air Force's diverse and complex operations. Our report discusses these problems and contains recommendations for corrective actions.

We are sending copies of this report to the Secretaries of the Air Force and Defense, the Director of the Office of Management and Budget, interested congressional committees, and other interested parties.

This report was prepared under the direction of David M. Connor, Director, Defense Financial Audits, who may be reached on (202) 275-9406 if you or your staff have any questions.

Charles A. Bowsher

Charles A. Bowsher
Comptroller General
of the United States

Executive Summary

Purpose

Through the 1980s there have been mounting concerns over the federal government's declining fiscal condition and the ineffective management and control over its financial operations. While various reforms are being considered and others are under way, more urgent and decisive actions are needed to deal effectively with these concerns and problems.

Over the last several years, GAO has conducted a number of financial audits of major federal civilian agencies and departments which show that government managers do not adequately (1) control their costs and resources, (2) provide the Congress and the public a true accounting for the assets entrusted to them, and (3) consider financial information in making decisions.

There is no better way to gain an understanding of the problems and required corrective actions associated with the financial management operation of an agency than to do a full scale audit of its financial statements. To begin to gain a perspective on the quality of the information and systems available in the Department of Defense (DOD), the largest department of government, GAO attempted to conduct a financial audit of the Air Force. The Air Force is the only military service which has tried to prepare a set of financial statements in accordance with generally accepted accounting principles for federal agencies.

Background

The Air Force is responsible for weapons systems, inventories, and other assets reportedly valued at $275 billion and, as of September 30, 1988, had thousands of outstanding contracts valued at over $250 billion. The Air Force annually receives appropriations of about $90 billion. It operates over 130 bases located throughout the world, representing about 16 percent of the real property held by the government and employs about 900,000 civilian and military personnel.

The Air Force dwarfs the largest organizations in the private sector as well as most other federal agencies. Being a government agency, the Air Force is not a profit making organization, but as one of the world's largest organizations, it needs to be concerned about, and should be held accountable for controlling its costs, operating efficiently, and protecting its resources. Accountability for its extensive operations can only flow from integrated systems that accurately capture, process, and report day-to-day financial transactions and provide firm control over costs and resources.

The integrity of these data and the systems that process them, as well as the reports used within and outside the organization, are best ensured by regular, periodic independent financial audits. Such audits provide the discipline needed to ensure that bad data, systems, and reports are highlighted for improvement.

To its credit, the Air Force attempted to produce a set of financial statements for 1988 and submitted them to GAO for audit.

Results in Brief

The Air Force does not have accurate cost data for almost all of its noncash assets such as inventory, equipment, aircraft and missiles. Accounts for over 70 percent of the assets on its consolidated statement of financial position were unauditable, and GAO was, therefore, unable to express an opinion on the financial statements for fiscal year 1988. Also, because of these weaknesses, the financial information produced by the Air Force and reported to the Office of Management and Budget and the Department of the Treasury is not reliable. In contrast, the fund control procedures, that is, making sure spending limits are not exceeded, generally operate effectively.

There are many reasons why the accounts were unauditable. The Air Force does not have financial systems that produce reliable financial data. A number of large dollar items—aircraft and accounts payable, for example—are not included in its accounting systems. A double-entry set of books with a general ledger system is not maintained to establish full accountability over costs and assets. To balance its accounts, the Air Force made a large number of adjustments—some over $1 billion—but the bases for these adjustments could not be explained by Air Force officials. The inventory systems do not provide reliable data to support either the quantities or the values of inventories on hand. There is not an accounting for the full cost of its weapons systems—the cost of the B-1 bomber system alone is understated by at least $7.1 billion in the financial statements.

The Air Force needs better historical cost data to improve its budgeting and planning processes and it needs better financial systems to establish accountability over the billions of dollars of assets entrusted to it.

The Air Force is not unmindful of some of its problems and has taken a number of actions to correct these problems on a case-by-case basis. That it took the initiative to prepare financial statements and have them audited is an important step. The Air Force also has long-term projects

under way that are intended to address several of its financial management weaknesses. But more needs to be done. It is evident that cost effectiveness and efficiency need to become an Air Force priority and an important part of the organization's culture if meaningful and lasting improvements in its financial management are to be achieved.

Principal Findings

Financial Systems Do Not Provide Reliable Financial Data

The Air Force accounting and financial management systems can neither provide complete and reliable financial data nor be depended upon to report accurately on the resources entrusted to its managers. Much information that is produced is not timely. Financial reports cannot be developed without extensive, manual, time-consuming efforts to compile data from a variety of sources. These conditions adversely affect financial reporting and management at all levels, ranging from the Air Force consolidated financial statements down to base-level financial reports.

The General Accounting and Finance System was to serve as the Air Force's general ledger, but a number of very significant accounts were not included. Certain data, such as aircraft values ($82 billion) and accounts payable amounts ($18 billion) had to be derived from property systems or from extracts of budgetary data rather than from a properly designed financial management system.

Financial reports to the Office of Management and Budget and the Treasury are also inaccurate and unreliable. In recent years, some Air Force components failed to submit financial data in time to be included in the year-end Treasury reports. As a result, March 31 data was used in lieu of missing September 30 data. Furthermore, over $25 billion of Air Force assets were not included in financial reports to the Treasury, and an additional $10 billion in transactions were counted twice.

Financial information requires constant analysis to ensure its validity. GAO's analysis of selected accounts revealed obvious problems, such as negative values for certain inventories. As a minimum, these warranted further investigation so that appropriate actions could be taken and corrections made. In many instances, Air Force officials simply have allowed obvious erroneous data to remain in the accounting records, and these data are ultimately included in agency financial statements and other financial reports.

As early as November 1983, the Air Force recognized weaknesses in the current systems and reported its general ledger accounting system as deficient to the Secretary of Defense. The Air Force subsequently contracted for the development of requirements for a new general ledger accounting system and currently is in the early stages of soliciting contracts to develop and implement it. However, this system does not directly cover the major portion of Air Force assets, and the Air Force does not expect it to be operational before 1994.

With the current and foreseeable budget constraints and changing military threat, 1994 is not soon enough to show major improvements. The Air Force will need to make major decisions in the near term and will need accurate data to make them. What the Air Force needs to do now is to take interim steps to improve the quality of data it derives from existing systems as well as undertake steps to upgrade and replace those systems. The choice between upgrading, replacing, or both should be based, in part, on the time it takes to achieve substantial improvement in the available financial management data.

Air Force Has Basic Internal Control Weaknesses

The Air Force has significant internal control weaknesses, some of which it disclosed in its 1988 Federal Managers' Financial Integrity Act report, and others which GAO noted in its audit work. The Air Force reported that two of its accounting systems, including the General Accounting and Finance System, did not conform to prescribed principles and standards.

GAO identified other material control weaknesses. Unsupported and arbitrary adjustments totalling billions of dollars were made to account balances and records throughout fiscal year 1988. The Space Systems Division trial balance for March 31, 1988, differed from its subsidiary records by $2.4 billion. In order to get agreement, records were adjusted without support. By not performing reconciliations and by making unsupported adjustments, accountability was lost and the opportunity to determine and address the causes of possible instances of mismanagement, fraud, or abuse was missed.

Full Costs of Weapons Systems Not Identified

The Air Force financial systems do not provide its managers with complete and reliable information on either the acquisition or operating costs of its aircraft and missile systems. For example, the procurement cost for each B-1 bomber is reported by the Air Force to be $150 million; GAO found that the cost is, in fact, about $219 million. The total reported

cost of the B-1 system—$21.9 billion—is understated by at least $7.1 billion. Similar understatements exist for the F-15 aircraft ($6.8 billion) and the F-16 aircraft ($6.3 billion). The gaps are even wider if all the government-furnished materials provided to contractors for aircraft production and related research and development are considered.

Air Force property systems do not track military hardware in the hands of contractors. For example, $630 million of satellites and $5.7 million of engines for C-20A cargo planes were paid for by the Air Force and held by contractors but not recorded in any Air Force property or accounting system.

Selected Acquisition Reports sent to the Congress include more accurate actual costs on weapons systems, but these costs were also not complete. As a result, actual cost information is not available in the accounting systems for reporting to top Air Force and DOD officials, the Congress, and the public, nor are such data available to Air Force managers for decisionmaking at any level.

Inventory Systems Do Not Provide Accurate Data

The Air Force maintains a reported $63.8 billion in inventories of supplies and spare parts, eight times the inventories reported by General Motors, one of the largest corporations in the United States. However, the systems used to provide accountability over these immense inventories do not provide reliable data supporting either their quantities or value.

GAO's current audit work, other recent GAO reports, and work by the Air Force all confirm that long-standing Air Force problems in controlling its inventories have not been resolved. Records of quantities on hand at Air Logistics Centers, which reflect about $40 billion in inventory items, are often inaccurate. Recordkeeping deficiencies contribute to $10 billion of unrequired inventory. In addition, over 50 percent of the dollar value of investment-item inventory at the Air Logistics Centers needs repair, overhaul, or extensive maintenance to become serviceable, yet such items are valued the same as usable items.

Loss of Accountability and Inaccurate Cost Information

When accountability and accurate cost information are not maintained, the following conditions result:

- Financial information needed for top management's or the Congress' analysis of Air Force trends is unreliable.
- Operating costs of air wings, bases, depots, and commands cannot be compared and evaluated.
- Losses can occur from fraud, waste, abuse, and mismanagement yet not be identified and their causes dealt with.
- Inventories cannot be managed effectively to avoid shortages or excessive stocks.
- Cost cannot be properly considered when deciding to replace or upgrade existing weapons systems.
- The basis for evaluating procurements and budget requests is not as complete as it might be.

There is no question that better cost data would improve the management control, budgeting, and planning processes of the Air Force. Only in cases where funds are unlimited and efficiency can be ignored can costs be considered unimportant. Neither case is true today—if it ever was true.

Recommendations

GAO is making recommendations to the Secretary of the Air Force to improve financial management and bring greater efficiency to Air Force operations. The recommendations focus on utilizing existing financial information and developing more accurate financial information (chapter 2), performing reconciliations and documenting adjustments (chapter 3), accounting for costs of weapons systems (chapter 4), achieving financial management of inventories (chapter 5), and developing a new accounting system (chapter 6).

Agency Comments

DOD concurred or partially concurred with all of GAO's recommendations. (See appendix IV.) In commenting on many of the recommendations, DOD cited initiatives, discussed in the July 1989 Defense Management Report sent to the President, as being responsive to GAO's recommendations. However, the Defense Management Report describes the efforts to achieve the initiatives' objectives in broad, general terms. It does not contain detailed plans or milestones of the specific actions that would be required to successfully implement the initiatives. DOD stated that it was

unable to provide a comprehensive response with milestones for corrective actions in time for inclusion in GAO's report. It said that a comprehensive response will be provided on the final report.

Overall, DOD said that it has been providing accurate and reliable data to the Congress on weapons systems, but it is aware that the Air Force accounting systems, including financial controls over inventories and government-furnished materials, need improvement. DOD also said that it will endeavor to make accounting and reporting data more consistent in future reports.

Contents

Executive Summary		2
Chapter 1 Introduction		14
	The Government's Financial Information and Control Environment	14
	Meaningful Financial Statements and Audits Can Strengthen Federal Financial Management	16
	Department of the Air Force	18
	Objectives, Scope, and Methodology	18
Chapter 2 Financial Management Systems Do Not Provide Reliable Financial Information		21
	Need for Meaningful, Accurate Financial Statements	22
	Unreliable Reporting to Treasury	26
	Financial Management Systems Are Not Used Effectively to Manage Resources	28
	Conclusions	33
	Recommendations	34
	Agency Comments and Our Evaluation	35
Chapter 3 Internal Control Weaknesses Prevent Accurate Financial Reporting and Reduce Accountability Over Assets		36
	Accounts Not Routinely Reconciled	36
	Account Balances Contain Unsupported, Arbitrary Adjustments	39
	Other Internal Control Weaknesses	41
	Conclusions	46
	Recommendations	46
	Agency Comments	47
Chapter 4 Actual Costs of Aircraft and Missiles Are Not Known		48
	Actual Cost of Aircraft and Missiles in Production Is Unknown	49
	Value of Aircraft and Missiles Is Not Based on Cost	50
	Government-Furnished Materials Not Included in Valuations	53
	Aircraft and Missile Modifications Are Not Capitalized	53
	Operating Costs of Aircraft and Missiles Are Not Known	54
	Controls Over Contractor-Held Property Are Not in Place	55
	Improvements Needed in Weapons Systems Cost Management	56

	Conclusions	59
	Recommendations	60
	Agency Comments	60
Chapter 5		61
Inventory Systems Do Not Provide Accurate Financial Data	Scope of Inventory Management Operations	61
	Inaccurate Records of Inventory Quantities	63
	Unreliable Inventory Values	65
	Change in Cost Accounting System Is Needed	67
	Other Inventory Weaknesses	68
	Conclusions	70
	Recommendations	71
	Agency Comments and Our Evaluation	71
Chapter 6		72
Air Force Financial Management System Improvement Efforts	Systems Alternatives for Developing Meaningful Financial Information	73
	Plans to Develop a New Base-Level Accounting System	74
	BLARS Status and Objectives	75
	BLARS Requirements	75
	Other Comments on the BLARS Development Effort	76
	Conclusions	78
	Recommendations	78
	Agency Comments	79
Appendixes	Appendix I: Consolidated Financial Statements of the U.S. Air Force for the Fiscal Year Ending September 30, 1988	80
	Appendix II: Comparisons Between Air Force Financial Statements and Treasury Reports	97
	Appendix III: Objectives, Scope, and Methodology	99
	Appendix IV: Comments From the Department of Defense	101
Tables	Table 2.1: Accounts Developed From Alternative Sources	24
	Table 2.2: Examples of AFSC Control Account Balances With Significant Changes	30
	Table 2.3: Variances in Divisional Trial Balances From Period to Period	31
	Table 2.4: Variances Among Divisional Trial Balances at September 30, 1988	31

Table 2.5: Air Bases With Credit Balances for Medical/Dental Stock Fund Inventories 32
Table 2.6: Air Bases With Credit Balances in Construction-In-Process Accounts 33
Table 4.1: Procurement Expenditures on Selected Aircraft Programs Calculated by AVISURS and GAO 52
Table 4.2: Expenditures on Selected Aircraft Programs Reported in SARs and Calculated by GAO 52
Table 5.1: Inventory Distribution as of September 30, 1988 63
Table 5.2: Unserviceable Inventory Not Reported as Such in Air Force Records 65

Abbreviations

AFAFC	Air Force Accounting and Finance Center
AFB	Air Force base
AFDW	Air Force District of Washington
AFLC	Air Force Logistics Command
AFSC	Air Force Systems Command
ALC	air logistics center
ANG	Air National Guard
ASD	Aeronautical Systems Division
AVISURS	Aerospace Vehicle and Equipment Inventory, Status, and Utilization Reporting System
BLARS	Base Level Accounting and Reporting System
CEMS	Comprehensive Engine Management System
CMD	Contract Management Division
DLA	Defense Logistics Agency
DMS	Depot Maintenance Service
DOD	Department of Defense
ESD	Electronics Systems Division
FMFIA	Federal Managers' Financial Integrity Act of 1982
GAFS	General Accounting and Finance System
GAO	General Accounting Office
GFM	government-furnished materials
GSA	General Services Administration
HUD	Department of Housing and Urban Development
NSN	national stock number
O&M	Operation and Maintenance
OMB	Office of Management and Budget
RADC	Rome Air Development Center
RFP	request for proposal
SAR	Selected Acquisition Report
SSD	Space Systems Division

Chapter 1

Introduction

Throughout the 1980s, concern has mounted over the federal government's declining fiscal condition and the ineffective ways in which it manages and controls its financial operations. From the beginning of the 1980s to the present, the government has faced the problem of a federal debt which has grown from about $900 billion to almost $3 trillion and which has incurred related interest costs (now about $241 billion, or 27 percent of the general expenses of the government). In addition, the government has become saddled with hundreds of billions of dollars in unanticipated liabilities which are not even included in the cash-basis debt figures cited above, but for which the government must ultimately bear the cost. On top of these liabilities are unmet national needs which will also require funding in future years and further add to the deficit.

These conditions were not sudden; the events causing them occurred over many years. Yet, the problems and their severity were not fully recognized. In most cases, the government was not tracking the costs of its obligations and needs as they were being incurred; in other cases, information was available to indicate the need for timely action, but this information was not taken into account in decisionmaking. It is time for these problems to be identified and dealt with.

The Government's Financial Information and Control Environment

In today's complex economic, political, and social environment, competing demands to fund government programs and activities require accurate and timely financial information for making sound resource allocation decisions. The government also needs to have proper financial control over its costs and assets to ensure that it is operating government programs in a cost-effective manner.

With distressing frequency, however, there are dramatic revelations in the media and elsewhere of financial improprieties by government officials or extremely wasteful practices by federal agencies. The reason these situations were allowed to occur—their root cause—is basically the absence of good internal controls and accounting systems. However, this fact is often overshadowed by the drama of the events themselves. The recent scandal at the Department of Housing and Urban Development (HUD) is a good example where the lack of good financial controls has seriously impacted several of the nation's housing programs and the integrity of government. HUD, however, is not alone. The Director of the Office of Management and Budget (OMB) recently testified before the Senate Committee on Governmental Affairs that "The recently-exposed HUD problems are not unique, not merely peculiar to a particular agency

under what some have described as absentee management....There are analogous problems in other agencies."

Those involved in such scandals are investigated and sometimes prosecuted, but the poorly controlled, antiquated, and ineffective financial environments which permitted the events to occur in the first place too often remain the same. Moreover, such environments also contribute to waste and inefficient use of resources, uninformed decisionmaking, and diminished public confidence in the government. Ultimately, these factors may be far more costly than the losses through fraudulent activities that surface from time to time.

Our evaluation of federal financial practices clearly shows that the government does not adequately control its resources; provide its managers, the Congress, or the public with a true accounting for the financial assets entrusted to it; or effectively use financial information to make decisions. In a 1985 special report, Managing the Cost of Government (GAO/AFMD-85-35A), we described six pervasive problems in the manner in which the federal government manages its financial resources and costs. These problems are

- poor quality of financial management information;
- poor linkages between the budgeting, budget execution, and accounting phases of the financial management process;
- inadequate attention paid to monitoring and comparing budgeted activity with actual results;
- primary emphasis on fund control, leading to inadequate attention in other areas of federal financial management;
- inadequate disclosure of assets, costs, and liabilities; and
- antiquated and fragmented financial management systems.

In a November 1989 report,[1] we cited a number of problems which are illustrative of the situation governmentwide. For example, the federal government continues to rely on antiquated accounting systems that, despite improvement efforts over many years, have serious problems. In other cases, federal agencies are spending billions of dollars developing and acquiring automated systems but are experiencing massive problems in the process. This report also cited the increase of spare parts inventories at the Department of Defense (DOD) and concluded that, while much of this growth resulted from increased costs due to

[1] Financial Integrity Act: Inadequate Controls Result in Ineffective Federal Programs and Billions in Losses (GAO/AFMD-90-10, November 28, 1989).

inflation and support for weapons systems modernization, a sizable portion represented unneeded inventories. The amount of unneeded secondary items increased from approximately $10 billion in 1980 to about $29 billion 1988.

Meaningful Financial Statements and Audits Can Strengthen Federal Financial Management

In response to mounting concerns of the public, the Congress, the media, and executive branch officials over the federal government's fiscal condition, a number of federal agencies have undertaken major initiatives to improve and modernize their financial practices, systems, and controls. This represents a mammoth and difficult task, given the years of neglect and low priority given to financial management, the size and complexity of federal operations, and the magnitude of taxpayers' dollars involved. Yet, these are the very factors which make it so critical that these operations be placed under sound financial control.

Decisionmakers who direct federal programs, like their counterparts in private industry, need to know the cost of prior decisions in arriving at the most economical solution to present problems. Air Force and DOD management, the Department of the Treasury, the Office of Management and Budget, and the Congress also need to regularly review the results of operations and the financial position of the federal agencies they oversee. The data for such accountability reporting should flow from financial management systems that can accurately capture, process, and report day-to-day transactions involving billions of dollars. The integrity of these data, the systems that process them, and the resultant internal and external reports can only be relied upon when they are produced by the kind of disciplined process that results from annual independent audits.

As part of the reform effort for better financial management, several federal agencies have attempted to develop meaningful financial statements, along with underlying records and documentation adequate to permit an independent auditor to express an opinion on the statements. The process of generating and accumulating financial information necessary to prepare accurate and meaningful statements instills discipline in the system and strengthens accountability. This discipline is further enhanced when the statements and the underlying information are subjected to the rigors of an audit. Financial statement audits ensure that accounting transactions, accounting systems, financial statements, and financial reporting to the Congress, Treasury, the Office of Management and Budget, and the public are properly linked and consistent. Such audits also provide the opportunity for an independent evaluation of the

adequacy and effectiveness of the controls and safeguards for protecting the resources entrusted to an agency and for ensuring that the agency fully and fairly discloses its financial condition and operations.

The importance of financial statements and independent audits has long been recognized by the private sector and, more recently, in the public sector on the state and local levels. Audited annual financial statements of federal entities, prepared according to generally accounting accepted principles and standards,[1] are urgently needed to provide useful, reliable information to the Congress, federal managers, and the public in a readily understood format.

Over the past several years, our financial audit work at both the civilian and defense agencies shows similar patterns of shortcomings. Essentially, these involve weaknesses in the basic controls over the accuracy of financial data, and the fact that all financial information needed for effective management, accountability, and oversight is not produced and utilized. It is noteworthy that the majority of these entities have received qualified or adverse opinions on their financial statements because of financial weaknesses. We have noted that, typically, improvements are made after initial audits, but many of these entities must make substantial long-term improvements in correcting weaknesses in internal controls and need to develop sound, integrated accounting systems capable of producing complete, accurate financial information.

Having good financial information is particularly important in the Department of Defense, which, in this era of budget constraints and changing world conditions, will likely have to live with no-growth, or even declining, budgets in the foreseeable future. DOD's 5-year defense plan contained programs which reportedly would cost about $150 billion more than DOD can expect to receive during the period. This will force difficult choices of which programs to terminate or curtail and how best to finance those that are to be continued. DOD must not only adjust its proposed programs and spending patterns to recognize current fiscal realities, but it must also achieve greater efficiency and more effective management of future appropriations and the resources it already has on hand. To effectively do so, DOD must have complete and accurate data on its costs and resources. These data can only be produced by a fully

[1]These are contained in Title 2 ("Accounting Principles and Standards for Federal Agencies") of GAO's Policy and Procedures Manual for Guidance of Federal Agencies.

functional and complete accounting system disciplined by independent audits.

To begin to gain a perspective on the quality of the financial information and systems available in DOD, we attempted to conduct a financial audit of the Air Force. The Air Force is the only military service which has attempted to prepare a set of financial statements in accordance with generally accepted accounting principles for federal agencies. A copy of the Air Force's financial statements, upon which we did not express an opinion, is contained in appendix I. We concluded that the Air Force statements were unauditable.

Department of the Air Force

The Department of the Air Force, created in 1947, is responsible for preparing aerospace forces to perform offensive and defensive operations with the purpose of defending the United States, deterring aggression, and being ready to conduct warfare in conjunction with the other armed forces. To fulfill this mission, the Air Force has resources valued at about $275 billion and receives almost $90 billion in annual appropriations. The Air Force operates over 130 bases located throughout the world, representing about 16 percent of the real property held by the U.S. government. In addition to these facilities, the Air Force manages a reported $99.1 billion of weapons systems (aircraft, missiles, and engines) and a reported $63.8 billion of inventories of supplies and spare parts, which amounts to about 20 percent of the equipment and almost 30 percent of the inventories held by the U.S. government. The Air Force employs about 900,000 civilian and military personnel.

Objectives, Scope, and Methodology

Our review objectives were to (1) work with the Air Force to develop its first set of consolidated financial statements and establish a baseline for a full audit of the 1989 financial statements, (2) audit the account balances contained in the financial statements, (3) identify problems in the Air Force's financial management and accounting systems, and test the effectiveness of significant internal control procedures, and (4) identify opportunities for the Air Force to improve its financial management operations. In pursuing these objectives, we reviewed the accounts comprising the Air Force's 1988 financial statements and reviewed the Air Force's financial management operations, including key internal controls which relate to recording, processing, summarizing, and reporting financial data. This report covers significant internal control, accounting, and financial management issues as well as problems with respect to certain individual accounts.

This review included coverage of the Air Force's financial management operations and accountability for the primary resources—personnel, facilities, inventory, and equipment—it uses to accomplish its mission. We reviewed the Air Force's policies relating to its organization, accountability procedures, and financial management. We also considered previous reports by GAO, Air Force Audit Agency, Defense Audit Service, and Air Force pursuant to the Federal Managers' Financial Integrity Act of 1982. We discussed financial management operations and accountability procedures, functions, and processes with managers throughout the Air Force. We identified internal controls in the accounting systems and operations for the primary resources. Our audit tests focused on the key internal controls specifically related to financial management and accountability for resources.

Financial Management

The Air Force Accounting and Finance Center is the focal point for Air Force financial operations for the worldwide network of over 120 Air Force Accounting and Finance Offices and numerous disbursing agent offices. The center is responsible for accounting for all money appropriated to the Air Force and for reports to the Congress and financial managers throughout the government on the use of these funds.

The Air Force's financial operations are under the overall direction of the Assistant Secretary for Financial Management who functions as the Air Force's chief financial officer. The Air Force's financial management structure is decentralized. The Air Force Comptroller is primarily responsible for systems that account for, control, and report on appropriated funds and cash. Separate logistics and other systems support the Comptroller's general ledger accounting systems. We worked with the Air Force to develop an inventory of its financial management systems.

Weapons Systems Management

The Air Force Systems Command develops and purchases weapons systems (aircraft, missiles, and uninstalled engines). About $25 billion of the Air Force's fiscal year 1988 budget was designated for weapons systems acquisition. The Air Force had thousands of outstanding contracts valued at over $250 billion as of September 30, 1988. Accountability for these systems begins during production and extends through their use at air bases.

Inventory Management

The Air Force manages inventories of over 1.6 million different spare parts and supplies valued at over $60 billion. About $40 billion of the

inventory is maintained at air logistics centers and about $20 billion at air bases. Managing the inventory includes not only maintaining physical control and distribution, but also contracting to acquire the items and then using the inventory to maintain operations. Depot maintenance industrial fund activities are collocated with air logistics centers and use their inventories to maintain and repair weapons systems.

We conducted our review between July 1987 and January 1990, using data related to fiscal year 1988. Our review was performed in accordance with generally accepted government auditing standards. Work was performed at Air Force headquarters in Washington, D.C., and locations worldwide.

Chapter 2 discusses financial management systems and procedures in the Air Force, while chapter 3 contains a discussion of weaknesses in basic internal controls which prevent accurate financial reporting and reduce accountability over assets. Chapter 4 identifies problems the Air Force faces in determining the actual costs of military hardware. Concerns about the quantities and valuation of Air Force inventories are contained in chapter 5. Chapter 6 discusses Air Force efforts to improve its financial management systems. The Air Force's consolidated financial statements are included as appendix I, a comparison of the consolidated financial statements with Treasury reports as appendix II, and our scope and methodology as appendix III. Comments from the Department of Defense are included as appendix IV.

Chapter 2

Financial Management Systems Do Not Provide Reliable Financial Information

The magnitude of assets and funds for which the Air Force is responsible is matched by only a handful of other organizations worldwide. The Air Force is recognized as a world leader in developing and operating weapons systems on the cutting edge of technology to provide security for the United States and its allies. In contrast, the Air Force financial systems and practices for controlling and managing its immense array of assets and vitally important and complex operations are unquestionably obsolete and incapable of providing the kinds of reliable financial information every organization needs for effective and efficient management. The poor state of the Air Force's financial management is clearly indicated by the fact that it was not able to produce a set of credible financial statements, something most business entities and many state and local governments do routinely and regularly.

The accounting and financial management systems generally do emphasize fund control requirements, that is, making sure spending limits are not exceeded. With some exceptions, we noted that fund control is adequate; expenditures did not exceed appropriations. However, the systems do not effectively account for and control the actual costs incurred.

The Air Force operates a total of 131 different accounting and financial management systems, many of which are not linked under an integrated general ledger. Moreover, some assets, including the Air Force's major weapons systems—reportedly valued at $99.1 billion—are not under the control of any accounting system. In short, the Air Force does not provide basic double-entry accounting control over significant portions of its financial operations.

The existing financial systems do produce data which could be used to help plan for, manage, and control resources. All too often, however, such data are not considered in the normal course of operations nor used to perform analytical techniques which would disclose operating problems. Similarly, when the financial systems produce information which is obviously wrong or merits investigation, these problems are often ignored.

This results in unreliable financial reporting both internally and externally. The processes which could not produce acceptable financial statements are the same processes providing information to Air Force management at all levels and to outside organizations such as Treasury and the Congress.

Need for Meaningful, Accurate Financial Statements

Financial statements provide an overall picture of the financial health and operations of an entity that cannot be obtained elsewhere. Producing the financial statements requires a discipline throughout the organization to properly account for the resources entrusted to managers to perform their mission. The financial information produced by this process can be used by managers to assess the varying, complex operations in an agency and to monitor the performance of subordinates against expectations through the costs and budgeted funds.

The Air Force's efforts to produce consolidated financial statements for fiscal year 1988 represent a substantial commitment to improving its overall financial management. However, these efforts were hindered by the fact that much of the information needed to produce the statements was not maintained on a systematic, consistent basis under basic double-entry accounting control. The Air Force does not have an integrated general ledger system from which statements can be produced. Also, the information it does record is not as useful as it could be because the Air Force does not follow generally accepted accounting principles in valuing its equipment and it does not record depreciation for all of its depreciable assets.

Air Force Lacks an Integrated General Ledger

The Comptroller General's accounting principles and standards (Title 2) state that an agency's accounting system must be an integral part of its total financial management structure and must (1) provide sufficient discipline and effective internal control over operations to protect appropriated funds, cash, and other resources from fraud, waste, and mismanagement, and (2) produce reliable and useful financial information on the results of operations to support decisionmaking. Accordingly, a general ledger serves as an integral part of an agency's financial management system and as an essential control mechanism by summarizing all of an activity's financial data for top management and decisionmakers.

The Air Force, however, lacks a double-entry general ledger system to provide a consolidated source of such financial information. To account for its resources, the Air Force operates a large number of financial management systems. Working with the Air Force, we identified 131 systems which it uses: 84 are classified as accounting systems and 47 are systems that feed data to these accounting systems. Taken together, these systems are supposed to (1) account for, control, and report on the

status of the Air Force's appropriated funds and cash, (2) maintain supporting records and other resources, and (3) accumulate the cost of decisions and actions in carrying out the Air Force's mission and operations.

The Air Force's 47 subsidiary systems were established primarily to support the Air Force's various program and administrative missions and goals, such as major weapons systems, procurement, and inventory management. These systems also serve as a starting point to authorize and initially record detailed information on the financial effects of its mission operations eventually recorded in the accounting systems.

The Air Force's 1988 annual report prepared pursuant to the Federal Managers' Financial Integrity Act of 1982 (FMFIA) contained the Air Force's annual assessment of its accounting systems' compliance with accounting principles, standards, and related requirements for federal agencies. The Air Force reported that two of its primary accounting systems, the General Accounting and Finance System (GAFS) and the Defense Integrated Financial System, did not substantially conform with the required accounting principles and standards.

The Air Force attempts to use GAFS to fulfill the functions of a general ledger system. It was designed to record, process, summarize, and report the financial results for the various Air Force activities. However, according to Air Force officials, GAFS was not implemented in a manner permitting it to satisfactorily perform these functions. As a result, neither GAFS nor the underlying financial systems provide all the data on accounts needed to prepare financial statements or other financial reports.

Information Needed for Financial Statements Not Produced From Accounting Systems

A general ledger system should serve as the basis for preparing financial statements and other financial reports. However, the Air Force's financial statements did not flow from and are not supported by either a general ledger system or subsidiary accounting systems. The Air Force used alternative sources to obtain the necessary data for its financial statements. In some instances, the data for the financial statements were developed from budgetary subsystems within GAFS. While the budgetary subsystems operated within the financial management structure, the accounting data were not routinely processed into the general ledger accounts and had to be developed based on extract programs written specifically to pull together financial data from budgetary reports for

the financial statements. In other instances, the data were developed from property systems that had no accounting function.[1]

The general ledger also should ensure that all transactions are accurately processed and recorded. Because the Air Force used a variety of unrelated sources for preparing financial statements, it has no assurance that material errors and omissions did not occur. Table 2.1 contains examples of accounts developed from alternative sources for the financial statements. The fact that the Air Force had to derive account balances from other sources is, in our opinion, a matter of concern because these accounts—such as aircraft, missiles, and engines—represent the major line items on Air Force's financial statements.

Table 2.1: Accounts Developed From Alternative Sources

Dollars in billions

Account description	Amount	System where data were obtained
Aircraft	$82	Property
Missiles	10	Property
Uninstalled engines	7	Property
Aircraft under construction	15	Budget
Missiles under construction	3	Budget
Depreciation expense and accumulated depreciation for buildings	10	Property
Accounts receivable	2	Budget
Accounts payable	18	Budget
Expenses	70	Budget
Revenue	70	Budget

Our audit showed that these various systems cannot be pulled together to produce reliable financial statements. Moreover, the absence of a fully integrated general ledger system to maintain the above accounts means that (1) financial management reports other than financial statements cannot be prepared with assurance of reliability and (2) monthly or other periodic financial management reports cannot be prepared on a timely basis.

[1]For example, as discussed in chapter 4, the Air Force's accountability (property) systems used for weapons systems tracks the location of military hardware, but the costs of acquiring the weapons systems are not fully accounted for.

Generally Accepted Accounting Principles Not Followed for Equipment Valuation

Title 2 requires equipment to be valued at historical cost, that is, the actual costs expended to acquire the equipment and put it into operation. The Air Force, however, values its equipment using a standard cost which is intended to approximate the cost to replace the equipment.

The Air Force's Consolidated Statement of Financial Condition for fiscal year 1988 reported that it had equipment valued at $26.8 billion. This consists of such things as vehicles, machinery, furniture, and computers which it generally purchases from either the General Services Administration (GSA) or the Defense Logistics Agency (DLA). When the Air Force acquires a new piece of equipment, or DLA or GSA changes its price for the kinds of equipment items owned by the Air Force, the Air Force revises the recorded values for all like items it holds. This can be extremely misleading for longer-lived assets of these types, when coupled with failure to record depreciation. Essentially, under this practice, old pieces of equipment with limited remaining utility are valued as if they were brand new items.

Depreciation Accounting Practices Could Improve Financial Reporting

Title 2 requires federal agencies to record and report the depreciation for capitalized assets in the financial statements of revolving fund activities (such as the Air Force's industrial funds). The principles further encourage the reporting of depreciation by all federal functions and activities such as general fund activities. Revolving funds function much like commercial entities which provide goods and services to customers. Accordingly, revolving funds need to recover costs associated with providing goods and services. General funds, on the other hand, are used to fund the day-to-day operations of an entity. While general funds do not operate on a cost-recovery basis, recording depreciation for general fund assets help allocate the assets' cost over their useful life.

Our review found that the Air Force did compute, record, and report the required depreciation amounts for its revolving funds and for general fund assets of aircraft and buildings. However, it did not record depreciation for other general fund assets of equipment which had a reported value of $26.8 billion. Further, consideration regarding the application of depreciation concepts to missiles is needed to determine whether it is appropriate to record depreciation on missiles. Although not currently mandatory, we believe that reporting depreciation on all the Air Force's capital assets would improve its financial reporting.

Unreliable Reporting to Treasury

The Department of the Treasury requires federal agencies to prepare and submit to Treasury annual financial statements as part of an effort to upgrade accounting and financial reporting within the federal government. The reporting requirements also serve to establish a sound financial management foundation for improving the reliability of accounting systems and, therefore, the financial reports they produce. Moreover, Treasury uses the agency reports to prepare consolidated governmentwide reports, which provide information to the Congress and the public about overall government performance and stewardship.

Incorrect agency financial reports adversely affect Treasury's and OMB's ability to evaluate agencies' financial performance because the analytical techniques Treasury is developing use the data in agency financial reports. For example, analysis of turnover and use ratios covering extended periods could help assess whether inventory is being used efficiently and could identify emerging trends. However, analysis of such information is only as good as the data being analyzed. If the data are not accurate, the analytical results are at best questionable, if not incorrect and misleading.

The financial information produced by the Air Force and reported to the Department of the Treasury is not reliable. The same accounting systems and practices which produce the financial statements are also used for reporting to other government entities. Accordingly, these reports do not contain accurate cost information for almost all of the Air Force's non-cash assets—such as inventory, equipment, aircraft, and missiles. In addition, these reports have an additional shortcoming because they are not carefully prepared.

In 1986, Treasury issued requirements for agencies to annually report their financial position (SF 220). The SF 220 shows an entity's assets, liabilities, and equity similar to the consolidated statement of financial position. In 1987, Treasury augmented its reporting requirement to require all agencies to submit a report on their operations (SF 221). The SF 221 shows the annual financial results of an entity's activities, including expenses, revenues, and other financing sources such as appropriations; the SF 221 is similar to a consolidated statement of operations. Each of these Treasury reports is on a fiscal year basis, and Treasury requires them to be submitted by November 15 each year, 46 days after the close of the fiscal year.

Air Force officials stated that, prior to our audit, a number of Air Force components failed to submit financial information to the finance center

in sufficient time for inclusion in the department's year-end reports to Treasury. Therefore, finance center personnel routinely used March 31 data for these components in preparing the year-end Treasury financial statements. For fiscal year 1988, all Air Force components submitted their financial data to the finance center in time for preparation of the Treasury reports except the Air National Guard (ANG). Finance center personnel used March 31, 1988, data for ANG in lieu of the missing September 30, 1988, data. The March 31 data understated ANG assets by about $534 million and liabilities by $29 million.

Both Title 2 and the Treasury Financial Manual require similar financial statements to be prepared at each year-end. Both require the preparation of financial statements by each major fund type and consolidated statements on the entity. Both require that all intra-agency transactions and balances be eliminated from the consolidated statements.

The fiscal year 1988 consolidated financial statements which Air Force prepared contained additional accounts not reported in the Treasury reports. For example, the financial statements recorded depreciation on aircraft and buildings, losses due to aircraft crashes, and appropriations to be provided for accrued annual and military leave balances to be liquidated in future periods. These accounts should have been reflected in the Treasury reports.

A detailed comparison of the Treasury reports with the consolidated financial statements is shown in appendix II. Our comparison of the accounts reported in the Treasury reports with the consolidated financial statements shows the following:

- The Air Force omitted asset accounts for aircraft and missiles under construction ($18.2 billion) from the Treasury reports.
- Intra-agency balances were not eliminated as required by Treasury regulations, thus double-counting certain accounts. For example, reimbursements from one Air Force appropriation to another were included as financing sources by both appropriations, thereby overstating total Air Force funding sources. Similarly, Air Force units remitted $3.4 billion to the Depot Maintenance Service and $6.1 billion to the Air Force Stock Fund for maintenance services and supplies. These transactions were not eliminated and resulted in overstatements of revenues and expenses at the Air Force consolidated level, distorting the results of Air Force operations for the year.

To provide meaningful, comparable data, financial reports need to record all the resources the agency is responsible for managing, plus the adjustments necessary to eliminate intra-agency transactions, to more accurately show the costs of operating the agency.

Financial Management Systems Are Not Used Effectively to Manage Resources

Despite their shortcomings, the existing financial systems do produce some data which could be used to help plan for, manage, and control resources. All too often, however, such data are not considered in the normal course of operations nor used to perform analytical techniques which would disclose operating problems. Similarly, when the financial systems produce information which is obviously wrong or merits investigation, these problems are often ignored.

The Air Force's financial management systems primarily operate as fund control systems intended to ensure that budgetary resources are available to meet obligations. However, even with this limitation, these financial management systems can nonetheless provide much useful information on the status of the Air Force's resources. Air Force managers have not been routinely analyzing available data to identify problems or potential problems within their operations.

Analysis of such financial data can point to potential problem areas and equip managers with convincing support for changing the direction of programs. Comparisons can be made of expected (or budgeted) performance with actual results, or performance from one period to another, or performance between one operating unit and another. While minor differences in performance are expected, significant deviations from management's established expectations should be investigated. This will result in the early detection of problems occurring in the operation of a program or activity, or in the need to reexamine management's expectations.

Analysis of Financial Accounts Not Used to Identify Potential Errors

The Air Force's financial management systems do produce some financial information which can be used to reveal potential financial management problems. However, many routine financial reports, such as monthly stock fund trial balances and semiannual general fund trial balances, are produced but apparently are not acted upon by managers. Air Force regulations do not require any such analysis, nor are analytical reviews of financial data emphasized by Air Force top management.

Comparative reports of operations were generally prepared only for budgetary purposes and not for analysis of financial data from one period to the next. Only the Depot Maintenance Services (DMS), Air Force Industrial Fund, performed a comparative analysis of account balances. DMS managers were working to address some of the problems surfaced by the comparison.

We compared account balances reported in fiscal year 1987 with fiscal year 1988 data and found several instances of significant fluctuations in records at all levels of the Air Force. The Air Force had not identified these fluctuations. We found instances at two air bases where Air Force managers could have avoided certain financial problems or, at a minimum, contained them more effectively through earlier detection had a comparative analysis been performed. We pointed out the following examples to the Air Force, which subsequently initiated investigations:

- At Sembach Air Force Base, suspense accounts[2] held significant uncleared balances, and trial balance accounts varied significantly from September 30, 1987, to September 30, 1988. A follow-up of these suspense account balances and variances by managers at the base would have identified that stock fund billings were not being made against operations and maintenance funds, and managers could have limited the losses incurred by the stock fund. The loss sustained by the stock fund was at least $82,000 and, as of September 30, 1988, Sembach's suspense account still had a balance of over $525,000 in unprocessed and, in certain instances, undocumented and unidentifiable transactions. For a single air base, these amounts represented major problems.
- The Air Force District of Washington failed to receive $15.7 million in reimbursements from other appropriations because billings were not timely. By the time management realized a problem existed with billings for reimbursement, documentation to support the billings was no longer available. If managers at the base had reconciled sales to billings as recorded in the Standard Base Supply System, they could have detected a problem which had existed for over a year. As a result of the billing problems not being detected, records to research the billings and make corrections, which are retained for only 90 days, were no longer available, and the stock fund could not be reimbursed.

DMS managers, on the other hand, analyzed the financial data to track time lags in contractor reporting of material on hand and billings. At

[2]Suspense accounts are generally used to hold miscellaneous unidentified transactions of an entity until they can be researched to decide the proper treatment and classification of the transactions.

each of the three DMS activities we visited, credit (negative) balances for government-furnished materials in-transit to contractors ranged from about $7 million to $12 million. At two DMS activities, contractor-acquired property showed credit balances of about $3 million and $7 million, respectively. However, management was aware that the credit balances in these asset accounts were improper and monitored the problem until corrective actions could be made.

We also found significant variances in Air Force Systems Command account balances from year to year. Although a significant variance may not be the result of an error, such variances should be investigated to verify the appropriateness of account balances. As shown in table 2.2, at the Air Force Systems Command (AFSC) headquarters, the consolidated general funds control accounts had substantial changes that were not questioned and, when we inquired, could not be explained by Air Force officials.

Table 2.2: Examples of AFSC Control Account Balances With Significant Changes

Dollars in billions

Account	9/30/87	9/30/88	Change
Accounts Receivable-Reimbursable	$.3	$.8	+166%
General Expenses	21.6	6.1	−72%
Sales of Services	1.3	.5	−62%
Collections-Transfers Out	1.6	.9	−44%
Disbursements-Transfers Out	24.4	8.9	−64%

The significant increase in accounts receivable and the decrease in collections indicate potential problems developing in the collection of accounts. Also, the drop in general expenses, coupled with a decrease in disbursements, could indicate that information is not being reported to AFSC by the payment centers and/or the rate of progress payments is slowing. This might indicate to management that monitoring the progress of contracts should be given closer attention. These examples illustrate some of the ways that accounts can be analyzed to identify potential problems in Air Force operations.

This type of analysis would also be useful at the level where the individual trial balances are initially prepared. As shown in table 2.3, trial balances prepared annually by the product divisions and other AFSC

activities[1] contained variances in account balances from year to year that could not be explained by managers.

Table 2.3: Variances in Divisional Trial Balances From Period to Period

Dollars in millions

Location	Account	9/30/87	9/30/88	Change
SSD	Net Investment	$2,084	$3,159	+52%
ASD	General Expense	456	237	−48%
ASD	Disbursements	504	13	−97%
RADC	Disbursements	189	245	+30%

The significant decreases in the Aeronautical System Division's expenses and disbursements should be investigated, particularly since these two accounts normally are closely related, but disbursements decreased substantially more than expenses.

In addition to comparing information from period to period, useful analysis can be performed between units with similar missions. We noted a number of differences among various product divisions' trial balances as of September 30, 1988, as shown below:

Table 2.4: Variances Among Divisional Trial Balances at September 30, 1988

Dollars in millions

Account	ASD	ESD	SSD
General Expense	$237	$1,908	$0
Disbursements	13	5,489	0
Net Investment	7,731	2	3,159

Management should question why, in the case of ASD, expenses were much greater than disbursements, whereas at the Electronics Systems Division (ESD), disbursements exceeded expenses by almost three times. In any case, it is highly unlikely that an entity would have incurred no expenses nor have made any disbursements for the year, as in the case of the Space Systems Division.

[1]These divisions include the Space Systems Division (SSD), the Aeronautical Systems Division (ASD), and the Rome Air Development Center (RADC).

Abnormal Account Balances Not Followed Up

In addition to analyzing data related to significant variances, analysis also needs to be made of the reasonableness of stated account balances to ensure the quality of the data. Generally, account balances for specific classes of accounts will carry a normal or predictable balance. For example, asset accounts will generally carry a positive, or debit, balance. We found accounts reported from the base level to the command level and on to the Air Force Accounting and Finance Center (AFAFC) level with abnormal balances, such as negative, or credit, balances in asset accounts. Air Force officials could not explain why there were credit balances.

As shown in table 2.5, at six air bases, credit balances were reported for asset accounts in the medical/dental stock fund trial balance as of September 30, 1988.

Table 2.5: Air Bases With Credit Balances for Medical/Dental Stock Fund Inventories

Dollars in thousands

Location	Credit balance
Air Force District of Washington	$54
Columbus AFB	283
Lowry AFB	112
Reese AFB	63
Williams AFB	52
Wurtsmith AFB	54

The purpose of preparing the trial balances is to provide information to be used to manage the operation of an entity. However, with significant errors found in the trial balances, the stock fund manager could neither use the trial balances to compare the relative performance of the stock fund's activities at one Air Force activity with another, nor to maintain visibility over resources used in the stock fund's operations.

Table 2.6 shows bases where negative balances were also reported in the construction-in-process accounts. Three air bases under the Strategic Air Command reported negative construction-in-process balances to the command, which is clearly an error for an asset account. This information was then consolidated and reported to the finance center.

Table 2.6: Air Bases With Credit Balances in Construction-in-Process Accounts

Dollars in millions

Location	Credit balance
Anderson AFB	$5.8
Beale AFB	8.4
Minot AFB	22.7

It is unlikely that the managers at either the base level or at the command level could use the inaccurate information reported in these records to ascertain the status of construction at these bases. Management needs to determine the cause of these inaccurate balances and make necessary corrections to ensure the quality of the data to be used in decisionmaking at all organizational levels.

Management Control Reports

We recognize that, in addition to dollar-based reports, there are other important indicators of efficiency and other bases for planning and making strategic decisions. However, accurate dollar-based management reports which disclose historical cost information are essential in every enterprise concerned with cost-effectiveness. Such reports should deal with such things as inventory and other asset management, base operations, budgetary, and strategic planning alternatives. This chapter illustrates that historical cost data are not generated in a manner designed to be reliable and timely and that little attention is paid to the data which are generated.

Conclusions

Managing any private or public enterprise involves the control of resources to produce results. The manager's job is to achieve goals at the least practicable cost, to make the best possible use of the resources entrusted to him or her, and to stay within spending and other limitations. Agency managers and the Congress need reliable, timely, consistent financial data as a basis for identifying problems, reaching decisions, and judging whether or not policy decisions have been properly implemented. Now more than ever, agencies need accurate, reliable financial information to make more informed decisions and reap the benefits of financial analysis to identify potential problem areas and inefficient operations as well as to better utilize their scarce assets. Preparing annual financial statements provides a discipline to provide accurate, reliable financial data so managers can have information to supplement their current decisionmaking process, enabling better, more informed decisions.

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Recommendations

The Air Force has a long-range plan, as discussed in chapter 6, for a new accounting system to deal, in part, with these problems and those discussed in chapters 3 through 5. However, until the new system is developed, the Air Force needs to use its present financial management systems to its best advantage. The Air Force also needs to work toward producing auditable financial statements in the near future. We plan to continue working with the Air Force on its financial management operations and systems. Accordingly, based on matters discussed in this chapter, we recommend that the Secretary of the Air Force

- develop an overall plan specifying corrective actions and milestones for the Air Force to produce consolidated financial statements in accordance with Title 2 that will be submitted for independent audit,
- give high priority to developing an integrated accounting system capable of generating reliable financial management reports on a timely basis, and
- develop management reports designed to assist to achieve cost-effectiveness and efficiency.

Until such time that these systems and reports can be developed, we recommend that the Secretary direct his Chief Financial Officer to

- correct deficiencies identified in existing systems to the fullest extent possible;
- investigate unusual and abnormal account balances;
- perform a periodic comparative analysis of account balances from one period to the next and follow up and explain significant variances;
- perform, to the fullest extent possible in light of existing systems deficiencies, comparative analyses of operating units across time periods and of other cost centers to determine efficiency of operations;
- accumulate and report actual costs of equipment in accordance with Title 2; and
- generate more reliable and complete financial information for reports to the Department of the Treasury and for annual consolidated financial statements.

Additional recommendations relating to the present financial management systems appear in later chapters.

Agency Comments and Our Evaluation

DOD stated in its response that the Air Force will be required to develop a plan to adhere to executive branch financial statement requirements. We believe this is an important step. The most serious financial weaknesses discussed in this report, including the lack of a general ledger system (chapter 2), material weaknesses in internal financial controls (chapter 3), incomplete accounting for weapons systems costs (chapter 4), and unreliable records of inventory quantities (chapter 5) all directly affect the financial statements required by the executive branch. However, the Air Force also needs to include in its plan several additional steps, such as developing adequate descriptive footnotes to the statements and ensuring adequate accrual for all income and expenses, in order to make them meet Title 2 requirements. The Air Force has already made significant progress in improving its financial management by developing consolidated financial statements and furnishing them to GAO for audit. Such reporting and audits are necessary to ensure that systems of internal control are adequate. Further, properly prepared, audited financial statements enhance accountability and provide greater discipline for management.

DOD agreed that the Air Force needs an integrated accounting system, but it did not agree that the Air Force's financial reports were unreliable and not timely. However, the executive branch financial reports currently produced require extensive manual efforts to prepare and included material errors in fiscal year 1988. We believe that implementing an integrated accounting system will enable the Air Force to more quickly and accurately satisfy all of its financial reporting requirements.

We agree with DOD that it does produce some management reports that address cost-effectiveness and efficiency. However, we identified opportunities for additional reports and analysis of financial data based on accurate historical cost information that can enhance managers' ability to more effectively and efficiently monitor and use their limited resources.

In discussing its comments, DOD asserted that the actual costs of equipment could be developed from existing systems. However, in working with Air Force officials during the course of the audit, neither we nor the Air Force identified a system or procedure that would provide the actual costs of equipment.

Chapter 3

Internal Control Weaknesses Prevent Accurate Financial Reporting and Reduce Accountability Over Assets

Weaknesses in basic internal controls together with unreliable financial management systems and the resulting billions of dollars of errors in account balances adversely affect the reliability and accuracy of financial statements and other financial management information used by the Air Force. Effective financial management requires strong systems of internal control to help ensure the integrity and reliability of financial information, to safeguard assets, and to promote conformity with proper operating procedures.

Air Force management is responsible for establishing and maintaining a system of internal controls, including accounting controls, in accordance with the Accounting and Auditing Act of 1950 and the Federal Managers' Financial Integrity Act of 1982 (FMFIA). The objectives of a system of internal controls are to help provide management with reasonable, but not absolute, assurance that (1) obligations and costs are in compliance with applicable laws, (2) funds, property, and other assets are safeguarded against waste, loss, and unauthorized use or misappropriation, and (3) assets, liabilities, revenues, and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over agency assets. These objectives are not being met by the Air Force.

During our review, we found areas of internal control weaknesses that need to be addressed by the Air Force. Specifically, the Air Force needs to focus on internal control procedures over the preparation of adjustments to financial records, the reconciliation of accounts between subsidiary/supporting and general ledger records, and other internal control problems which were significant to a particular organizational level within the Air Force but not pervasive to the Air Force as a whole. These matters are covered in this chapter. Other control weaknesses specifically related to inventories and weapons systems are discussed in the following chapters.

Accounts Not Routinely Reconciled

Title 2 requires that reconciliations between summary and detailed records be periodically performed and documented and that adjustments, if necessary, be made promptly to properly bring these records into agreement. If two sets of independently derived records do not agree, management is alerted to a potential problem and can follow up quickly to determine the reasons for lost assets or failed procedures and correct the errors or system weaknesses. Reconciliation procedures require identifying, investigating, and resolving all discrepancies

between general ledger type control accounts and subsidiary records and, where warranted, making the appropriate adjustments to either the subsidiary records or to the general ledger or control accounts.

We found that reconciliations between subsidiary records and the control accounts are not always performed to ensure the accuracy and propriety of recorded account balances. In addition, we found instances where the accounting records showed that disbursements had been made that exceeded the corresponding obligation amounts, and the Air Force had not investigated why this occurred. Such occurrences could indicate that disbursement information is being incorrectly recorded, contractors are being overpaid, or the Anti-Deficiency Act is being violated.

Control Accounts Not Reconciled With Subsidiary Records

Our audit tests revealed that the control accounts were not regularly reconciled with subsidiary records which provide the detailed support for the summary-level data recorded in the general ledger accounts. This occurred at three Air Logistics Centers (ALCs), which maintain the Air Force's inventories of spare parts and supplies, and at three Depot Maintenance Service (DMS) activities, which repair and maintain Air Force equipment and weapons systems. We identified and presented the following discrepancies to local officials for investigation.

- At Warner Robins ALC, one account had a negative balance of $2.1 billion, although the account balance should normally be positive or zero. The general ledger accountant said that he had no documentation to support the account balance and that the account had been in error since 1983.
- At the San Antonio ALC, subsidiary data in the Contractor Repair Inventory System, which is used to control parts provided to various contractors for repair, did not agree with control account balances for materials with contractors. During our audit, we found that the general ledger account for materials provided to contractors was overstated by $697 million, while the account for the repair parts was overstated by $169 million. This discrepancy indicates poor control over government-owned materials and equipment with contractors.
- The Ogden ALC general ledger included $379 million in equipment, an amount which was also included in the DMS general ledger. The Air Force requires reconciliations between these two systems in order to detect duplications and errors, but we found that the prescribed procedures were not followed. For example, some of the data necessary to properly perform the reconciliations were either never considered or were

recorded twice—once at the Ogden DMS and once at the San Antonio DMS. Since the reconciliations were not properly done, incorrect adjustments to the accounts were made, simply compounding the problem.

Similar problems have been recognized in our prior reports on DOD agencies. For example, we reported "arbitrary and erroneous reconciliations,"[1] and we reported that internal controls over in-transit material at one of the ALCs were inadequate because the Air Force did not reconcile individual payments and receipts.[2]

Further, at two bases we visited, year-end stock fund account balances for recording sales of inventory items to base units could not be reconciled to subsidiary records generated by the supply management system. The base units reimburse the stock fund with Operation and Maintenance (O&M) funds. Neither we nor base officials could fully resolve these discrepancies because necessary documentation of transactions between the stock fund and base units had not been retained. Since the stock funds are revolving funds and are reimbursed for sales by customers' appropriated funds, the failure to be reimbursed in effect supplements the customers' appropriated funds improperly. Congressional intent on use of appropriated funds is circumvented when customers receive items from the stock funds without paying for them.

Disbursements Not Reconciled With Obligation Balances

The Air Force Systems Command did not properly reconcile its disbursement transactions with supporting records of obligations as required by Air Force regulations. Systems Command records disclosed that, as of September 30, 1988, almost $7 billion in disbursements was not reconciled with obligation records. Reconciliations of disbursement transactions to supporting records of obligations are essential to monitoring and controlling contractor payments and ensuring compliance with the Anti-Deficiency Act. The act provides that no officer or employee of the United States shall make or authorize an expenditure from or create or authorize an obligation under any appropriation or fund in excess of the amount available therein (31 U.S.C. 1341). The act also provides that no officer or employee of the United States shall authorize or create any obligation or make any expenditure in excess of an apportionment or in excess of the amount permitted by regulation (31 U.S.C. 1517).

[1] Navy's Progress in Improving Physical Inventory Controls and the Magnitude, Causes, and Impact of Inventory Record Inaccuracies in the Army, Air Force, and Defense Logistics Agency (GAO/NSIAD-84-9, November 4, 1983).

[2] Inventory Management: Receipt Confirmation Problems (GAO/NSIAD-88-79, July 14, 1988).

The Systems Command awards contracts while other organizations (for example, the Army, Navy, and Defense Contract Administration Services) are responsible for making the actual payments to contractors. The organization making the actual payments then provides payment information to the Air Force Accounting and Finance Center, which verifies the information and forwards it to Systems Command. Both the payment office and Systems Command are responsible for ensuring that the payments do not exceed the obligations and that correct appropriations are charged. The Systems Command either accepts the transactions if they are found to be for proper disbursements or it rejects and returns them to the Finance Center if they are deemed improper. Acceptance requires the Systems Command to match the disbursements with the related obligations and to notify the Finance Center that the transactions are accurate and proper.

Reconciliations are a key control in ensuring that payments do not exceed obligations on contracts and that funds are properly spent. When payments exceed obligations (also referred to as negative unliquidated obligations), management needs to initiate immediate corrective action. These issues are discussed in our recent report,[1] which recommended that negative unliquidated obligations already recorded be resolved and that quarterly reports on the amount and age of the negative unliquidated obligations be submitted to management.

Account Balances Contain Unsupported, Arbitrary Adjustments

Title 2 requires that documentation of transactions and other significant events, including adjustments to accounting records, be complete and accurate so that transactions and related information can be traced from their initiation, through their processing, to their completion. Compliance with this standard requires that documentation be purposeful and useful to managers and auditors involved in analyzing operations. Air Force regulations also require that adjustments be adequately documented.

We found that adjustments totaling billions of dollars were made to account balances and records throughout fiscal year 1988. We did not find records to adequately document the purpose of many of these adjustments, and Air Force officials could not provide a reasonable explanation for them.

[1]Financial Management: Air Force Records Contain $512 Million in Negative Unliquidated Obligations (GAO/AFMD-89-78, June 30, 1989).

There are legitimate and necessary reasons for making adjustments to accounting records, such as correcting errors, posting accruals to recognize expenses and related liabilities, or writing off assets which are no longer of value. However, without adequate safeguards, adjustments to accounting records could also be used for any number of illegitimate or improper purposes, such as covering up defalcations, hiding losses of assets, or masking errors. Accordingly, from an internal control standpoint, it is essential to establish internal controls which ensure that only legitimate, authorized adjustments are made and that clear documentation is maintained to explain their basis and purpose. Such documentation allows for detection and systematic correction of errors and establishes that adjustments were made for a valid purpose and were authorized and executed by personnel acting within the scope of their authority.

Our audit work revealed that many significant adjustments to accounting records appeared incorrect, were of questionable purpose, and were not documented. Because of the lack of documentation, we could not determine whether these adjustments were appropriate or whether the affected account balances were accurately stated. Air Force officials could not explain these adjustments.

Our audit tests of adjustments revealed that certain undocumented adjustments were made to force control accounts and subsidiary records to agree, as shown in the following examples:

- The control accounts in the Space Systems Division's trial balance for March 31, 1988, differed from its subsidiary records by $2.4 billion. To get the two systems to agree, an adjustment was made which charged the difference to the subsidiary system. The effect of this adjustment was to reduce assets and decrease the Other Operating Gains and Losses account. However, Space Systems Division officials could not provide documentation to support the adjustment, nor could they explain how the difference between the trial balance and subsidiary records arose. Simply masking discrepancies is not a proper use of adjustments.
- At Sembach Air Force Base, we found over $214,000 in undocumented adjustments that were apparently made to force the control accounts to agree with subsidiary records. These adjustments were charged to a suspense account designed to identify transactions which need to be reviewed. When management uses suspense accounts (accounts with transactions that have not yet been classified for posting to their proper accounts), it should also institute controls over the transactions entered into these accounts to ensure that they are promptly classified and

removed from the suspense accounts on a timely basis. However, we noted several examples where suspense accounts were not being properly used at Sembach. For example, an unsupported adjustment of $82,000 was made during fiscal year 1988 to force the fuels inventory control account to agree with subsidiary records. Some of the unsupported adjustments were attributed to the actions of a disgruntled employee in the finance office who failed to properly process transactions, entered erroneous data into the materiel accounting system, and destroyed source documents. An investigation is under way to determine if any fraud occurred.

- At the Systems Command, our audit tests disclosed unsupported adjustments of $500,000 that were made to obligation and expenditure accounts for Operations and Maintenance appropriations in September 1988. Officials could not explain the adjustments, nor could they find any documentation to show why they were made.
- At the three ALCs we reviewed, the interfaces between the perpetual inventory tracking systems and inventory accounting system did not function properly. As a result, the two systems reported different amounts on hand for the same items. To compensate, either each month or each quarter, the accounting and finance office adjusted the accounts in the inventory accounting system to force them to agree with the perpetual inventory tracking system's balances. However, the discrepancies between the systems were not researched to determine their causes. The net effect of such adjustments for fiscal year 1988 decreased the inventory accounts by about $361 million. At our request, Ogden ALC officials researched $241 million of its September 30, 1988, adjustment and found that $114 million was the result of inventory system errors, while $127 million resulted from coding and timing errors. These errors had been masked by the improper adjustments and would not likely have been detected had we not asked base officials to investigate.

Air Force regulations require that supervisors and managers review and approve all adjustments. However, many of the adjustments discussed above were not provided to higher levels of management for their review and approval. Not submitting adjustments for review and approval circumvents essential internal controls and could allow adjustments to be used to hide errors, fraud, or misuse of assets.

Other Internal Control Weaknesses

Our review disclosed several other internal control weaknesses that were significant to particular organizational levels within the Air Force's management structure but not pervasive to the Air Force. We

discuss these problems in more detail and make recommendations to correct the problems in separate reports evaluating the internal controls at (1) base-level operations, (2) Systems Command operations, (3) Air Logistics Centers, and (4) Depot Maintenance Services, Air Force Industrial Fund.

Weaknesses Found in Base-Level Operations

Internal control weaknesses contributed to the inaccuracy of financial reporting by the base-level general accounting and finance system. We found the following conditions during our review of base-level operations.

- Reconciliation of civilian payroll and personnel master records is not performed. At the Air Force District of Washington, the payroll office had not reconciled its records to personnel records since May 1986. This reconciliation is the primary control to ensure that civilian employees are paid as authorized by the base personnel office. This comparison serves to identify any errors or irregularities such as improper pay rates or fictitious employees.
- Discrepancies in shipments of materials are not always researched. Internal controls to ensure proper recording of goods shipped to bases are not always performed. Follow-up listings which are used to prompt follow-up for missing or damaged goods are not always prepared. Additionally, when the follow-up listings are prepared, required reports which document resolution of the discrepancy are not always produced. Weak controls over shipments could result in the Air Force's paying for defective items or goods it does not receive.

We determined that the Air Force bases do not consistently report construction-in-process. During construction of, or improvement to, base facilities, the bases should periodically recognize as assets the construction performed or improvements made. This is accomplished by recording the appropriate amounts as "construction-in-process." At three of nine bases tested, construction-in-process was not properly recorded.

At one base, the construction of a new aircraft hangar was not recorded in the base property records. According to the real property officer, the base does not routinely account for costs associated with construction-in-process unless the Air Force acts as the construction agent. According to a contracting officer, failure to record construction-in-process in the accounts caused an understatement of assets of at least $39 million.

Conversely, recording unfinished construction, or improvements, in the completed building account overstates building cost and depreciation before the useful life of the building commences. One of the bases tested had seven facilities under construction as of September 30, 1988, with a cost at that time of $8.5 million. The base prematurely recorded these facilities in the completed buildings account at an estimated completion cost of $16.4 million, thus overstating assets by about $7.9 million.

Once construction has been completed, the associated costs should be moved from the construction-in-process account to the completed facilities account. At one base, we found that a completed project for $79,960 had been recorded in the completed building account. However, the cost of the project had not been removed from the construction-in-process account, thus causing an overstatement of that amount.

Weaknesses Found at Systems Command

Our tests of the authorization, approval, and financial reporting for contracts to acquire major weapons systems showed that budget authority and obligation and expenditure transactions were not recorded promptly. When these transactions are not recorded in a timely manner, managers receive incomplete financial information. This same information is then used to determine if funds are available for other procurement actions. The result is that managers are then more likely to commit, obligate, and expend more funds than were authorized for a program or contract.

- Budget authority: The Electronic Systems Division (ESD) requires budget authority to be recorded in GAFS within 3 days of receipt of the source documents. We found that 362 of the 557 budget authority entries were not recorded within 3 days, and 262 of the transactions were not recorded within 7 days.
- Obligations: ESD requires obligations to be recorded within 5 calendar days of receipt. We found 100 of 165 obligations we tested were not recorded within 5 days. Further, 30 of the obligations were posted between 11 and 20 days after receipt, and 24 were recorded over 21 days after receipt. Similarly, the Space Systems Division requires obligations to be recorded within 7 days, and we found that 71 of the 202 obligations we tested were not recorded within the 7 days.
- Expenditures: Neither the Air Force Systems Command nor the Air Force had criteria for the number of days it should take for expenditures to be recorded. We reviewed a total of 278 expenditures at three product divisions and the Rome Air Development Center and found that 214 were not posted within 10 days.

The late posting of commitments and obligations affects the accuracy of Air Force Systems Command's financial reports—available funding could be overstated. To the extent that program managers rely on these financial reports to commit and obligate funds for procurements, the inaccurate reports would cause them to misinterpret the amount of funds available and exceed a contract's obligational authority.

Weaknesses Found at Air Logistics Centers

Based on audit work performed, we found the following weaknesses at the ALCs:

- Inventory adjustments are not timely. The Air Force Logistics Command regulations require that any adjustment or correction to inventory records be made within 21 days. However, we noted at the Ogden ALC that over 10 percent of the adjustments we reviewed exceeded the criteria, with processing times ranging from 23 to 113 days. Accurate records of inventory quantities on hand are critical for maintaining readiness. Good internal control would alert management to any adjustments which were not promptly made.
- Disbursements are not recorded on a timely basis by ALCs. Financial reports issued and used by the ALCs misstated the status of central procurement funds by hundreds of millions of dollars. We found time lags of up to 492 days from the date that contract administrators paid a contractor until the ALCs, which are responsible for contract funding, learned of the disbursement. The significant overstatement of unliquidated obligations in these reports is potentially misleading for those Air Force managers who use the data in making decisions on resource allocation. At the San Antonio ALC, we studied 75 disbursements reported from the Army, Navy, or another Air Force base. We found that it took from 95 to 230 days for San Antonio to receive data on 63 of the transactions. It took from 303 to 492 days before San Antonio was notified of the other 12. There were similar occurrences at the Ogden ALC, with time lags ranging from 118 to 385 days.

Weaknesses Found at Depot Maintenance Services

Managers must strengthen controls relating to the issuing and accounting for materials and for the accountability, depreciation, and disposal of equipment used in the repair of items at depots. Current controls do not ensure proper safeguarding of these materials and equipment or the proper reporting of the results of the Depot Maintenance Services' operations.

- Controls over material costs. Controls over the $513 million of material costs incurred by DMS during fiscal year 1988 did not (1) ensure that material was charged to the correct job or (2) limit material quantity issues to actual job requirements. As a result, the DMS could be issuing materials in excess of those needed for its repair functions, and material costs for specific jobs may not be correctly reported. For good internal control, the DMS should know how much material each type of job requires. The Air Force reported the failure to limit material quantities to actual job requirements as a control weakness in its FMFIA report for fiscal year 1988.
- Controls over equipment. Our testing over the acquisition, transfer, depreciation, and disposal of industrial equipment disclosed (1) erroneous posting to equipment accounts, (2) incorrect adjusting entries, (3) unrecorded equipment, and (4) facility costs misclassified as equipment costs. As a result, the financial data and reports are not accurate or reliable, and accountability for equipment is not effectively maintained.

In addition, as of February 20, 1990, we were still awaiting the Air Force's response to our December 21, 1989, inquiry concerning several issues identified during our audit. Specifically, we have asked the Air Force to explain its authority to transfer $76.5 million of fiscal year 1988 Operations and Maintenance appropriated funds to DMS and to fund certain military construction work with DMS funds.

On November 12, 1984, a building at the Oklahoma City ALC was extensively damaged by fire. On August 27, 1985, about $76.5 million of fiscal year 1985 O&M funds were "passed through" to DMS for fire costs. The transfer converted $76.5 million of O&M funds available for fiscal year 1985 to DMS funds with no fiscal year constraints. The Air Force may transfer funds between O&M and DMS under statutory authority included in each Defense Appropriations Act if certain prescribed procedures are followed. Since we are not aware that the Air Force followed the procedures for transfer when the $76.5 million was transferred to DMS, the transfer may have been improper.

Our audit also identified about $24.5 million of DMS funds which were used to finance six line-items in a contract to restore the DMS facilities damaged by the fire. These items ranged in estimated prices from $400,000 to $10.6 million. The work represented by these items may have been a military construction project which had to be financed from military construction appropriations rather than from DMS. A military construction project consists of all military construction work necessary to produce a complete and usable facility or an improvement to an

existing facility (10 U.S.C. 2801). A military construction project which costs more than $1 million generally must be specifically authorized by law (10 U.S.C. 2802). Such projects may also be carried out by the Air Force under statutory authorities to conduct emergency construction (10 U.S.C. 2803) or to restore facilities which are lost or damaged (10 U.S.C. 2854). However, emergency and restoration projects under these authorities which cost more than $1 million must be financed out of the military construction appropriation. Our review of the work financed by the $24.5 million in DMS funds indicates that restoration may have been a military construction project costing more than $1 million. If so, the Air Force may have carried out an unauthorized military construction project and may have improperly funded the project with DMS funds.

Conclusions

Effective financial management requires strong systems of internal controls to help ensure the integrity and reliability of financial information, to safeguard assets, and to promote conformity with proper operating procedures. Although Air Force management is responsible for maintaining a system of internal controls, including accounting controls, our review identified pervasive control weaknesses, such as not routinely reconciling account balances and adjusting account balances without adequate support or documentation. We also identified a number of control weaknesses that were significant to specific organizational levels within the Air Force. In many cases, these weaknesses resulted from noncompliance with Air Force regulations.

The Air Force is not alone, however, in its failure to attain a sound internal control environment. Our recent report illustrates the seriousness of the internal control and accounting system problems encountered in the federal government in recent years and the need for a vigorous program to correct these problems.[4]

Recommendations

We recommend that the Secretary of the Air Force direct the Chief Financial Officer to

- report the internal control problems with reconciliations and documentation for adjustments in FMFIA reports to the Secretary of Defense;
- reconcile subsidiary records periodically to the control accounts and correct errors and weaknesses;

[4]Financial Integrity Act: Inadequate Controls Result in Ineffective Federal Programs and Billions in Losses (GAO/AFMD-90-10, November 28, 1989).

- reconcile disbursements with obligations and promptly correct errors;
- document all adjustments to subsidiary records and control accounts;
- enforce Air Force's requirement that supervisors and managers review and approve all significant adjustments; and
- report unsupported adjustments and reconciliation internal control problems, if applicable, in future FMFIA reports.

Agency Comments

DOD concurred with the recommendations presented above.

Chapter 4

Actual Costs of Aircraft and Missiles Are Not Known

Federal financial management systems should provide for both fund control to monitor spending authority within appropriation limits and the accumulation of actual cost data to account for and manage available resources. Information provided by a financial management system should complement other program information and enable decisionmakers to more effectively fulfill an agency's mission. The Air Force accounting systems, however, do not provide reliable information on Air Force weapons systems—which include aircraft, missiles, engines, satellites, and other major components. This information is needed for oversight and funding decisions, such as evaluating alternative weapons systems or modifications to existing weapons systems, for the Air Force's multibillion dollar programs.

Air Force accounting systems do not record the billions of dollars invested in aircraft, missiles, and engines. During production of weapons systems, program managers know whether appropriations are available to purchase these systems but do not have timely and accurate information on their cost. Furthermore, Air Force financial systems do not routinely provide managers with accurate, reliable information on the operating costs of these weapons once they have been purchased. More specifically, the reported cost of aircraft and missiles is not based on the actual cost of production and usually does not include the costs of government-furnished materials (GFM). Furthermore, the subsequent costs associated with aircraft and missile modifications are not capitalized. Instead, military hardware is valued using an estimated unit cost that is determined at the time of initial delivery. That cost is not subsequently adjusted for actual cost information. Accordingly, the reported costs of all military hardware are grossly understated and the actual costs could not be determined at September 30, 1988. This was one of the factors preventing us from expressing an opinion on the Air Force's fiscal year 1988 consolidated financial statements.

The decisions to purchase weapons systems are based on many factors, such as the ability to respond to military threats. However, it is important that managers consider the actual operating and capital costs of existing weapons systems before deciding to request appropriations to upgrade or replace these systems. Such information is also relevant to other decisions and to cost-effectiveness. Moreover, actual cost information is needed for meaningful reporting to the Congress and the public, and it instills the discipline needed to control resources and to maintain accountability.

Actual Cost of Aircraft and Missiles in Production Is Unknown

Air Force financial management systems focus on maintaining fund control to ensure that current expenditures do not exceed available appropriations, but not on accounting for resources used and costs incurred. As a result, program managers do not get timely and accurate information on the cost of military hardware in production. This diminishes the Air Force managers' ability to manage procurement effectively and ultimately to accurately assess the value of completed military hardware.

In fiscal year 1988, approximately $25 billion was appropriated to the Air Force to procure military hardware. At October 1988, the Air Force had contracts valued at $255 billion to procure aircraft, missiles, engines, and other military hardware. Air Force military hardware procurement, which is managed by the Air Force Systems Command, includes highly technical, state-of-the-art weapons systems. A single piece of military hardware, such as a B-1B bomber or an MX missile, can cost several hundred million dollars.

Financial controls are established at the point of purchase or when orders are placed to ensure that funds will be available to procure items. Program managers monitor military hardware in production by tracking the number of items produced under the contract to ensure that funds are available to continue production. However, useful cost information on individual weapons is not maintained under systematic accounting control, and all costs associated with the production of a weapons system are not accumulated. It is virtually impossible to monitor the cost of a specific system in development as compared with the estimated cost to produce it. In addition, this leads to inaccurate reporting of costs to the Congress in Selected Acquisition Reports (SAR). (Inaccurate reporting to the Congress is discussed in greater detail later in this chapter.)

Delays in Reporting Expenditures for Weapons

Our audit disclosed that the Air Force's standard General Accounting and Finance System (GAFS) does not provide timely financial data to program managers responsible for acquiring military hardware. The organizational structure for procuring military hardware in the Air Force is complex and decentralized, involving several organizations within and outside the Air Force which fulfill such functions as administering contracts, approving payments, making disbursements, and recording and reporting disbursements. To effectively manage programs, timely and accurate financial information must be communicated among these organizations and be made available to program managers.

For example, contract disbursements made by the Contract Management Division (CMD) are recorded in the Acquisition Management Information System. However, this system does not interface with GAFS. Instead, disbursement data are routed from CMD through the Air Force Accounting and Finance Center to the accountable stations,[1] thereby creating substantial delays in recording that information. In addition, we found that the accountable stations did not record the disbursements in a timely manner once they had received them. While the Air Force had no criteria for the number of calendar days it should take to record the disbursements, we felt 10 days was a reasonable criterion. We tested 278 transactions and found that 214 took over 10 days.

In addition to delays in recording disbursement data from payment station to accountable station, we found a lack of reconciliation between the two. Due to the lack of reconciliations, Air Force managers cannot be assured that financial transactions are recorded correctly for aircraft and missiles in production. Reconciliations need to be performed regularly to detect and correct errors within Air Force Systems Command records. (See chapter 3 for a discussion on reconciliations of disbursements with obligation balances.)

Value of Aircraft and Missiles Is Not Based on Cost

The Air Force systems do not accumulate, account for, and report the actual costs of aircraft and missiles, nor is the value of completed military hardware based on the actual procurement cost. Title 2 requires that all property and equipment with an initial acquisition cost of $5,000 or more and an estimated service life of at least 2 years be accounted for at cost. After the Air Force procures a weapons system, the Air Force's accountability system is updated to show the location of the military hardware but not its full acquisition cost.

The Air Force Logistics Command (AFLC) is responsible for valuing military hardware and tracking its location, readiness, and status. AFLC uses an automated accountability system, the Aerospace Vehicle and Equipment Inventory, Status, and Utilization Reporting System (AVISURS), to track the location of Air Force weapons systems. This system was neither designed nor intended to serve as an accounting system. Nevertheless, the Air Force used AVISURS as the source for the weapons systems account balances included in the financial statements even though more accurate information on the costs was available in annual Selected

[1] An accountable station is the accounting and finance office related to the program office responsible for the weapon system for which the payment office made the disbursement.

Acquisition Reports sent to the Congress for recent weapons systems programs.

AVISURS generates asset valuations for Air Force aircraft and missiles based on the unit cost and the number of aircraft and missiles for each of the 253 specific classes/types of aerospace vehicles, such as the B-1B bomber or the B-52 bomber. Until May 1983, the unit costs which were input to AVISURS were provided by a manual containing information on the Air Force's various types of aerospace vehicles. The Air Force reportedly calculated these costs by dividing the total procurement costs by the total units acquired for each type of aircraft, an approach we believe to be valid conceptually. However, the Air Force stopped updating this manual in May 1983. Consequently, only 147 of its current fleet of 253 specific classes of aircraft and missiles have unit costs computed in this manner. For the 147, we compared the costs in the AVISURS system with those in the manual and found the two did not agree in 86 cases. Air Force officials could not explain the differences or show us how the costs had been developed for the 86 types of aerospace weapons.

The manual has not been kept up to date since May 1983. The unit costs for the remaining 106 of the 253 types of aircraft and missiles procured since 1983 were recorded in AVISURS based on telephone conversations with representatives of the Systems Program Office responsible for procuring the aircraft and missiles. Air Force officials stated that these unit costs were "initial fly-away costs"—the estimated average costs at the time the first aircraft or missile is delivered by the contractor.

This approach is not an adequate substitute for actual costs. Aircraft and missiles generally are delivered under many separate contracts at varying costs over several years and frequently include different electronics or payload capabilities which would affect the costs. However, once a unit cost is entered in AVISURS, it is not updated or revised regardless of actual costs. For example, we computed $219 million as an average cost for the B-1B bombers, based on the total procurement expenditures, while AVISURS reported a unit cost of approximately $150 million.

To determine whether the reported valuations for aircraft and missiles approximated the actual procurement expenditures or costs incurred, we analyzed the total procurement expenditures for several aircraft from 1973 through 1988 and found, as shown in table 4.1, that the AVISURS costs reported to the Finance Center were significantly understated. We consider our estimates to be conservative because we did not

include research, development, test, and evaluation costs associated with each type of aircraft, and the estimates are incomplete because they do not include the cost of government-furnished materials.

Table 4.1: Procurement Expenditures on Selected Aircraft Programs Calculated by AVISURS and GAO

Dollars in billions

	Costs reported by		
Type/class of aircraft	AVISURS	GAO	Difference
B-1B	$14.8	$21.9	$7.1
B-52	2.8	4.0	1.2
F-15	11.1	17.9	6.8
F-16	12.0	18.3	6.3

These few examples show that the total understatement of aircraft procurement costs may be on the order of tens of billions of dollars. We have not attempted to determine research, development, test, and evaluation costs.

Additionally, we compared our estimated costs for the B-1B, F-16, and F-15 with procurement expenditures reported in the respective SARs dated December 31, 1988. As shown below, the SARs' expenditures more closely approximated the costs we estimated.

Table 4.2: Expenditures on Selected Aircraft Programs Reported in SARs and Calculated by GAO

Dollars in billions

	Costs/expenditures reported by		
Type/class of aircraft	SAR	GAO	Difference
B-1B	$21.5	$21.9	$(.4)
F-15	18.5	17.8	.7
F-16	19.7	18.3	1.4

Due to the lack of detailed information, we were unable to reconcile the difference between our estimates and the expenditures reported in the SARs. While the SARs' amounts were more accurate than the costs reported in AVISURS, as discussed later in this report, the SARs' costs were also not complete. Cost systems that can track the accumulation of costs applicable to a project's development are crucial to effectively manage and control the cost of a project.

Government-Furnished Materials Not Included in Valuations

The costs of weapons systems are also understated because the Air Force does not incorporate in them the value of government-furnished materials. GFM includes parts, components, assemblies, and raw and processed materials. During the procurement of certain military hardware, the Air Force furnishes contractors these materials, which either become part of the end item or are consumed in the production of the end item. With few exceptions, GFM is provided without cost to contractors and thus is not included in the contract prices.

The Air Force values aircraft at initial fly-away cost and missiles and engines at average acquisition cost. Since government-furnished materials are not usually included, this substantially understates the cost of these assets. We were unable to ascertain the amount of understatement because data and records made available to us were incomplete. As a result, the real cost of producing an aircraft or missile is not known and, accordingly, cannot be reported to the Congress or other decisionmakers.

Aircraft and Missile Modifications Are Not Capitalized

The Air Force's valuation of military hardware does not include appropriate portions of about $25 billion incurred since 1973 for modifications made after acquisition. The Air Force often modifies existing military hardware to improve or enhance its capability and extend its serviceable life. Engineering and modification costs incurred after approval of the basic procurement contracts are only added to hardware costs when such changes result in a new category of weapons system. This practice significantly understates the investment in weapons systems.

Based on our review of the historical data contained in appropriation expenditure reports, we estimated that the Air Force incurred modification costs of $25.2 billion ($24 billion for aircraft and $1.2 billion for missiles) from fiscal years 1973 through 1988. These costs were not reflected in the asset valuations as of September 30, 1988, because the expenditures were processed through fund control systems and not captured in the property accounting records.

The Air Force needs to include the modification costs when it evaluates the total cost of maintaining and operating weapons systems. We were unable to determine how much of the $25.2 billion should have been capitalized or, in fact, was capitalized because relevant historical data were unavailable.

Operating Costs of Aircraft and Missiles Are Not Known

As with acquisition costs, the costs of operating and supporting weapons systems are not accounted for or included in the budget in a way that would allow the costs to be identified with a specific type of weapons system. In its 1987 report on the Department of Defense's appropriations bill for fiscal year 1988, the Senate Committee on Appropriations expressed its concern over the long-term implications of procuring weapons systems which have increasingly expensive operating and support costs. We initiated a separate review of the costs but had to terminate it in February 1987 because operating and support cost data were unavailable.

DOD has initiated several initiatives designed to improve the quality of information on operating and support costs. In an internal document, however, the Air Force has identified several concerns about reporting operating and support costs for its major weapons systems to the Congress. These concerns are stated as follows:

- "While every attempt was made to make the data reflect budget funding, not every cost element could be tracked directly to the budget. Some cost elements had to be modeled, i.e., estimated."
- "Fixed overhead items, such as system management and engineering, were allocated and were not variable with respect to a specific weapon system's activity or the number on hand."
- "The preparation of the data for the reports is very labor intensive. To make the data more precise and to accommodate accumulation of the data on a routine basis for annual budgets would require major changes to the DOD budget process."

The Air Force document also stated that because of the limitations in its ability to track costs for specific weapons programs, the operating and support cost data reported in the budget were not consistent with similar data reported by program offices for Selected Acquisition Reports. The Congress cannot provide oversight of the total costs associated with major weapons systems, planned or on hand, without accurate, complete operating and support costs for the weapons systems. An adequate cost accounting system would provide reliable data on each and every weapon in the Air Force's inventory and such information should be routinely available to the Congress. Also, from the Air Force management's perspective, it would appear extremely difficult to take meaningful actions to control costs if precise records of actual costs remain unavailable.

Controls Over Contractor-Held Property Are Not in Place

The Air Force does not have a system or procedure to track and monitor property owned by the Air Force but held by contractors. We found that (1) some satellites and engines paid for and accepted by the Air Force and held by contractors and (2) government-furnished materials which have been issued to contractors were not recorded in any Air Force property or accounting system.

When functions or controls are delegated to third parties, such as contractors, the government has a greater exposure to fraud, waste, and abuse. Even when a federal agency determines that delegating control of assets like GFM is the best course of action, that agency has a fiduciary responsibility to establish accountability and to exercise appropriate oversight and control.

Satellites and Engines Held by Contractors Are Not Accounted for or Tracked

We found that almost $630 million worth of satellites and about $5.7 million worth of engines for C-20A cargo planes that were paid for and owned by the Air Force and held by contractors were not recorded in any Air Force property or accounting system. The Air Force has property systems that effectively track the location of most of its equipment from the time it is received. Aircraft and missiles are tracked by AVISURS and engines by the Comprehensive Engine Management System (CEMS). The C-20A engines should have been recorded in CEMS but were not. The Air Force, however, has no system to track and account for satellites. While local managers had documents identifying the satellites and engines held by the contractors, higher-level managers had no access to these documents and were not informed of the costs associated with maintaining the assets at the contractors' facilities. More specifically, we found the following:

- Seven communications satellites costing over $630 million were stored for the Air Force at the production contractor's facilities. The seven satellites plus four more in production were scheduled for launch through 1992. In addition to the acquisition costs, the Air Force had incurred costs totaling $18 million for the contractor to store the satellites. Had the costs associated with storing these satellites been recorded and reported, Air Force managers would have been better able to evaluate whether the production should continue or be slowed to reduce the storage costs.
- At one air base, about $5.7 million in C-20A cargo aircraft engines were at the contractor for maintenance but were not recorded in the accounting system as being owned by the Air Force.

Government-Furnished Materials Are Not Accounted for or Tracked

Since 1967, we and DOD internal audit organizations have issued numerous reports on the management, use, and accountability of GFM. However, the Air Force has not developed a system or procedures to track or monitor GFM once it has been issued to contractors. Once issued, GFM is dropped from the Air Force's inventory records, leaving the contractor to account for the material in its possession. As a result, the Air Force does not usually include the cost of furnished items in the unit cost of military hardware.

We previously reported[2] that the Air Force procedures and practices for reviewing, validating, and approving GFM requisitions did not ensure that contractors would requisition and receive only needed items and quantities of GFM. Furthermore, weaknesses in both the contractor controls and government oversight over GFM provided to contractors have contributed to the accumulation of excess material. Since 1967, both we and congressional committees have criticized DOD and the Air Force for not establishing property accountability and financial accounting controls over GFM. We recommended in two reports[3] that accounting systems be established to adequately account for (1) the quantity and value of GFM authorized and provided to contractors and (2) the contractors' receipt and use of this material.

The long-standing problems with the management, control, and accountability for GFM continue. As a result, there is no assurance that (1) the government's sizeable investment in such property has been adequately protected and (2) the potential for waste, fraud, and abuse has been minimized.

Improvements Needed in Weapons Systems Cost Management

The Air Force's current financial reporting practices do not disclose the costs of investment decisions for weapons systems. Neither DOD and the Air Force nor the Congress and other decisionmakers have complete and reliable historical data on the costs of existing weapons. Moreover, decisionmakers do not have good historical cost information, some of which may be useful in evaluating the costs of proposed new weapons systems, although usefulness may vary depending on the degree of technological

[2]Government Property: DOD's Management of the Property It Furnishes to Contractors (GAO/NSIAD-88-151, May 26, 1988).

[3]Internal Controls: Air Force Can Improve Controls Over Contractor Access to DOD Supply System (GAO/NSIAD-88-99, March 18, 1988) and Government Property: DOD's Management of the Property It Furnishes to Contractors (GAO/NSIAD-88-151, May 26, 1988).

change being made. As a result, decisions are made based on incomplete and inaccurate data.

As it becomes necessary to look for ways to contain and even reduce the cost of defense, it is evident that the budget cannot finance all the weapons systems now being planned and developed. Even assuming that the defense budget were to grow 2 percent faster than inflation, the programs included in DOD's most recent 5-year plan will reportedly cost at least $150 billion more than the amount which will probably be available. While cost will not be the only factor in the difficult decisions on cuts and reductions, complete and reliable cost data will be needed to make informed decisions.

Inaccurate Reporting of Costs to the Congress

Since 1969, Selected Acquisition Reports have been the primary means by which DOD informs the Congress of the status of major weapons system acquisitions. SARS summarize estimates of technical, schedule, quantity, and cost information. However, they do not include actual contractor costs incurred to date or compare funded quantities to planned and actual contractor deliveries.

The Congress has repeatedly expressed dissatisfaction with the lack of timely and complete data in SARS. In 1982, the House Committee on Armed Services Special Panel report on Defense Procurement Procedures noted that "the SAR is inadequate in its reporting on major weapon systems to the Congress, thus inhibiting proper oversight."

In previous reports, we have suggested changes to improve SARS. Our February 1985 report[4] discussed a revised SAR format that would compare planned costs with actual costs and include estimates of the time needed to complete a project. The actual cost data should come directly from the Air Force accounting system. However, as previously discussed, the Air Force accounting system does not generate the actual cost of the weapons systems. Instead, the Air Force must resort to using the costs obtained from the various contractors' accounting systems. Accountability demands that Air Force management have its own cost information for control purposes. Dependence on contractors is a glaring symptom of the poor condition of the Air Force's financial management systems.

[4]Managing the Cost of Government: Building an Effective Financial Management Structure (GAO/AFMD-85-35 and 85-35A, February 1985).

We also reported[5] that the presentation of SAR reports has not been modernized to take advantage of computer technology that would improve timing and provide helpful graphics and data analysis. More recently, we reported[6] on how DOD could substantially improve the quality, timeliness, and presentation of data it provides to the Congress.

Cost Management of Weapons Systems

Both historical and future costs should be considered in decisions related to funding and selections of alternatives among weapons systems. However, as discussed in this report, the Air Force does not have reliable, complete information on costs, and important decisions are based on incomplete and inaccurate data. The following are examples of cost considerations:

- Comparison of costs among alternative weapons systems. The Air Force proposed that its close ground support aircraft (the A-7) be upgraded to help meet the air support needs of ground forces in the 1990s and beyond. The Congress was concerned about the aircraft's cost-effectiveness in meeting this need.[7]

  The total cost of the proposed A-7 PLUS was not known because (1) the Air Force had not decided on avionics and engine options, (2) studies on radar improvements, aircraft rewiring, and aircraft vulnerability could lead to additional aircraft modifications, and (3) the production schedule was uncertain.

  However, once these costs have been determined, the Air Force still would not have the total cost of the A-7 PLUS because the actual costs of the weapons systems, the GFM, and subsequent modifications are not properly captured in the accounting system. Moreover, because of the previously discussed weaknesses in how the Air Force assigns costs to its aircraft, it would not be in a position to compare the cost-effectiveness of the existing A-7 with that of the proposed A-7 PLUS.
- Weapons systems cost growth. In 1983, the Air Force analyzed alternatives for solving its long-term airlift capability shortfall. The alternatives were to buy additional C-5 aircraft or develop the C-17 aircraft.

[5]Selected Acquisition Report: Suggested Approaches for Improvement (GAO/NSIAD-86-118, July 17, 1986).

[6]Weapon Acquisition: Improving DOD's Weapon Systems Acquisition Reporting (GAO/NSIAD-90-20, November 14, 1989).

[7]Close Air Support: Upgraded A-7 Aircraft's Mission Effectiveness and Total Cost Unknown (GAO/NSIAD-88-210, September 2, 1988).

Even though Air Force systems did not have complete, accurate costs for existing aircraft, which would have been helpful in estimating costs for additional C-5 aircraft, they concluded that the C-17 was the cost-effective alternative.

While complete, reliable financial data may not have affected the ultimate decisions made in these situations, the decisions were made without such data.

Comprehensive Cost Information Would Improve the Air Force's Ability to Manage Weapons

While costs are considered to a limited extent by managers and decisionmakers, there are opportunities to better or more efficiently and effectively use costs in managing weapons systems. During the planning and budget development stages for weapons systems, actual costs of existing systems can be used to provide a baseline for many components of similar or upgraded weapons systems. During the procurement period and throughout the life of a weapons system, managers at all levels need to more closely monitor planned costs and actual costs. Such costs need to be carefully considered when decisions are made with respect to new acquisitions, modifications or upgrades, maintenance programs, and even operations. Knowledge of weapons systems costs, combined with good operating and other cost information, will provide a basis for ensuring cost-effectiveness in the Air Force.

Conclusions

Federal financial management systems should provide for both fund control to monitor spending authority within appropriation limits and the accumulation of actual cost data to account for and manage available resources. Information provided by a financial management system should complement other program information and enable decisionmakers to be more effective in fulfilling an agency's mission. Actual cost information can help provide (1) a basis for accountability for managers, (2) a fundamental basis to serve as a measure against budgeted costs and forecasts, and (3) historical data to assist in estimating budget requirements and evaluating alternatives.

However, the Air Force has no systems to accurately account for billions of dollars invested in aircraft, missiles, and engines. Furthermore, Air Force accounting systems cannot produce the operating and support costs for weapons systems. While the decisions related to weapons systems acquisition are based on other factors in addition to cost, such as the ability to respond to military threats, managers at every level must consider accurate data on the costs of alternatives when making funding

decisions. Moreover, actual cost information is not available for reporting to the Congress and the public. This kind of information is clearly needed for effective congressional oversight.

Recommendations

We recommend that the Secretary of the Air Force direct the Chief Financial Officer to

- accumulate and report actual costs of weapons systems, which include acquisition costs, GFM, operating and maintenance costs, and modifications;
- report actual and planned cost data to the Congress so better decisions can be made on program funding;
- account and report on satellites through either revisions to existing systems or a new system to provide oversight of these assets; and
- establish and implement procedures to identify and record in the accounting records equipment paid for and accepted by the Air Force but held by contractors.

Agency Comments

DOD concurred with all the recommendations presented above.

Chapter 5

Inventory Systems Do Not Provide Accurate Financial Data

The systems that are supposed to provide accountability and financial control over the $63.8 billion invested in inventories of spare parts and supplies do not provide accurate, reliable data supporting either the quantities or the value of these inventories. Using inaccurate information for purchase decisions can result in unnecessary procurement and excess inventories in some instances and shortages in others. Building inventories in excess of requirements wastes tax revenues that are sorely needed elsewhere. Conversely, inadequate inventories inhibit the Air Force's ability to fulfill its mission.

Air Force managers cannot be sure they have accurate information to use in determining when to procure items unless a physical count of supplies and spare parts is made. Serious inaccuracies in the pricing data for inventories compound the problem. Even if reliable data can be obtained, their usefulness is limited if the systems are not constructed to generate good cost accumulations. Accumulation of cost information in the accounting records can also provide information on cost trends useful for budgeting as well as information to help control operations. Accordingly, an inventory system which will satisfy such needs should be capable of

- assigning a cost to each stock item in the inventory;
- tracking the movement of inventory;
- maintaining records of input, usage, and quantities on hand;
- being reconcilable with physical counts;
- assigning a value to usage (such as average cost) identified by program or other classifications; and
- making comparisons with requirements.

The Air Force systems do not provide this information; therefore, it is not available for purchasing new inventory items in the most cost-effective manner, analyzing cost trends, or controlling material usage and repair costs.

Scope of Inventory Management Operations

The Air Force maintains a reported $63.8 billion in inventories of supplies and spare parts, eight times the inventories reported by General Motors, one of the largest corporations in the United States. These inventories are maintained at over 130 bases located throughout the world. Air Force inventory management is an extremely complex task due to the size of its operations, frequent technological obsolescence of

inventory items, and the need to decentralize storage for national security reasons. To maintain and support its operations and weapons systems, the Air Force manages about 1.6 million different types of spare parts and supply items. The Air Force Logistics Command (AFLC) and five Air Logistics Centers (ALCs) use a number of highly complex financial and logistics systems and subsystems to compute requirements, fill orders, track inventory quantities, and value inventory.

ALCs procure items on the basis of requirements computations, which in turn are determined by a variety of factors, including quantities of inventory items on hand, in transit, and in the repair process; projected usage rates; and procurement lead times. In recent years, we have issued several reports[1] relating to problems found in the requirements determination process. Among the problem areas reported are inaccurate systems and procedures for determining inventory requirements and identification of inventory inaccuracies and their causes.

The items purchased as a result of the requirements determination process are received at warehouses, stored, and issued to customers worldwide. During this process, perpetual inventory systems monitor the quantities of each item to provide accountability over the items (that is, where the items are and how many are at each location throughout the Air Force). Perpetual inventory systems are designed to track inventories on an item-by-item basis, increasing recorded quantities for each unit received and reducing them for each unit issued. This type of system can provide managers with up-to-date, detailed information on which to base decisions. However, periodic physical inventory counts are also needed to substantiate the information maintained in the perpetual system to ensure that all transactions were recorded properly and to account for any theft or spoilage.

Each inventory item maintained by Air Force has a unique national stock number (NSN) by which it is classified and recorded in the perpetual inventory system. For each NSN, hundreds or even thousands of individual units may be in stock at (1) one or more of the ALCs, where central inventories are maintained, (2) Base Supply units, where Air Force operating units have ready access to them, or (3) the Depot Maintenance Service, Air Force Industrial Fund operations (depots), where

[1] Air Force Budget: Potential for Reducing Requirements and Funding for Aircraft Spares (GAO/NSIAD-88-90BR, February 18, 1988), DOD Inventory Management: Revised Policies Needed (GAO/NSIAD-88-75, January 14, 1988), Military Logistics: Buying Spares Too Early Increases Air Force Costs and Budget Outlays (GAO/NSIAD-86-149, August 1, 1986), and Procurement: Spare Parts Initiatives Air Force Implementation (GAO/NSIAD-87-28, February 13, 1987).

they are used to repair and maintain aircraft, engines, missiles, and related components.

While ALCs are responsible for maintaining the bulk of the inventory, the air bases and the depots also maintain inventories to fulfill their respective missions. Table 5.1 shows the inventories at these activities.

Table 5.1: Inventory Distribution as of September 30, 1988

Dollars in billions	
Activity/location	**Value**
ALCs	$40.4
Depots	1.1
Air bases	22.3
Total	**$63.8**

Inaccurate Records of Inventory Quantities

Maintaining accurate records over inventories has been a long-standing problem for the Air Force. The inventory accountability systems which the ALCs use to track the location and quantities of inventory items do not provide reliable, accurate inventory data to managers. Inaccurate inventory records can cause critical supply shortages, prolonged delays in filling requisitions, or unnecessary procurements resulting in excess inventory. Although the Air Force has recently improved the accuracy of its data in automated perpetual inventory systems and generally takes accurate physical inventory counts, we believe the perpetual records are still too unreliable to be used in making effective and efficient decisions. A perpetual inventory system should be capable of providing data to answer the following questions:

- What inventory items were acquired and how much did they cost?
- Where did the inventory items go? (Data should be available both in terms of quantities and values.)
- How much inventory has been used?
- How much inventory is on hand? (Data should provide quantity, value, and location of inventory items.)
- How much inventory is needed or not needed? (Data should provide both quantities and locations.)

Problems with inventory accuracy have been the subject of congressional hearings and GAO and Air Force Audit Agency reports for many years. Some improvements have been made as a result of a number of programs the Air Force initiated to improve inventory accuracy. Since

1983, the AFLC has required random sampling of physical inventories at ALCs to obtain an objective measure of inventory accuracy. Data from these inventory observations showed that inventory accuracy in fiscal years 1987 and 1988 had improved over previous years. However, the data also showed that the perpetual inventory systems have not yet achieved a high degree of reliability.

Inventory Accuracy Is Still a Problem at ALCs

To assess the accuracy of inventory records, we selected random samples of inventory items at two ALCs, Ogden and Warner Robins. Further, to assess inventory procedures and controls, we observed and tested physical inventories performed by Air Force personnel. We made test counts during these inventories and compared the results with Air Force counts.

On the basis of our samples at the two ALCs, we estimate that (1) the counts for about 100,000 NSNs, with a value of about $5.7 billion, exceeded those in the perpetual inventory records, (2) the counts for about 82,000 NSNs, with a value of about $1.1 billion, were less than those in the perpetual inventory records, and (3) about 786,000 NSNs were correct. While many of the differences were not material, about 112,586 NSNs differed by 10 percent or more between the counts and the perpetual inventory records.

The volume of errors Air Force inventory teams detected also shows that records still need to improve with regard to quantity accuracy; the inventory management systems at ALCs still have not achieved reliability. During fiscal year 1989, some of the quarterly counts of 500 items have shown the perpetual records to differ by less than 10 percent, other counts have shown significant differences. For example, the San Antonio ALC's second-quarter inventory had initial unit accuracy of only 49 percent, and the Warner Robins ALC's third-quarter counts showed only 58 percent accuracy.

These significant differences show the ALCs' inventory records to be unreliable. Inaccurate inventory balances recorded in these perpetual inventory systems can lead to improper requirements determinations and, subsequently, to inappropriate procurement decisions.

Records of Inventory Quantities at Bases Appear Reasonable

We also tested the reliability of inventory records at 10 air bases. Using NSNs, we selected a sample of 2,341 supply items which comprised a quantity of 369,076 units valued at $24.8 million from a universe of $1.1 billion. Based on this sample, we found total overages of 239 units, or $175,445 (1 percent), and total shortages of 4,810 units, or $451,508 (2 percent). These differences, while of concern, show that air base inventory records are much more accurate than ALC records.

Unreliable Inventory Values

The Air Force does not accurately record and report the value of its inventories. Yet, such information is important to assess the cost of providing a service or doing a job (such as constructing a system or simply providing maintenance) and to maintain cost control as well as physical control. Air Force policy requires only that its inventories be valued at a price based on an item's most recent acquisition cost. However, the Air Force does not consider the condition or "serviceability" of inventory items when valuing them.

Unserviceable Inventory Reported at Full Value

Inventory values are not adjusted for the condition of the items in the inventory. Although about $7 billion (over 50 percent) of the investment-item inventory at three ALCs—Ogden, San Antonio, and Warner Robins—was unserviceable, it was valued the same as new inventory items. This practice significantly overstates inventory values and is misleading because the true inventory value is less than the amount shown and because there is a substantial additional cost to bring unserviceable items to a usable condition. Table 5.2 shows the values of unserviceable inventory, according to Air Force records.

Table 5.2: Unserviceable Inventory Not Reported as Such in Air Force Records

Dollars in billions

ALC	Total investment-item inventory	Unserviceable inventory	Percent unserviceable
Ogden	$3.4	$2.1	61.8
San Antonio	3.8	2.0	52.6
Warner Robins	5.0	2.9	58.0
Total	**$12.2**	**$7.0**	**57.4**

The military services maintain a large number of unserviceable items in their inventories for a variety of reasons. For example, a good argument can be made that it is more efficient to maintain components that are very expensive to repair and not in high demand under normal inventory control and repair them only when needed. Although this approach

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may provide effective inventory management, failure to consider and report the cost of repair is not acceptable for financial management. To show these items at the same value as fully serviceable items, when many require the investment of significant dollars before they can be used, significantly distorts the total value of the inventory and the financial statements.

Because of indications that over 50 percent of the $12.2 billion investment-item inventory at the three ALCs was unserviceable, we believe that it is important to know the repair costs and use that information in conjunction with new purchasing in order to properly decide whether or not it is cheaper to buy a new item or to repair an unserviceable one. Unless the records reflect estimates of repair costs, it is likely that the potentially lower cost of repairing such items versus the cost of purchasing new items will not be carefully considered. This can lead to decisions to purchase rather than repair, which could result in substantial overinvestment in inventories. The Air Force needs to develop a methodology which regularly adjusts the unserviceable portion of its inventory to reflect the costs associated with repairing these items.

Valuation Policy Is Acceptable but Not Consistently Applied

Title 2 requires inventories to be valued at the lower of cost or market. Since cost information is not readily available, we believe market valuation is an acceptable alternative. Market valuation involves application of either (1) current replacement cost (by purchase or reproduction) or (2) net realizable value (by sale or contemplation of sale), where completion and disposal costs and normal profit margin are considered. However, since the Air Force cannot readily sell its inventories because no market exists, current replacement cost by purchase or reproduction is a viable alternative. In applying this alternative, the Air Force inventory valuation policy generally considers the last acquisition cost plus a surcharge for government-furnished materials and transportation to be the value assigned to inventory on an item-by-item basis.

We found, however, that the Air Force did not consistently apply its inventory pricing policies, which results in erroneous and misleading inventory valuations. Under the Air Force policy, after the Air Force assigns values to inventories of spare parts and supplies based on the item's latest acquisition cost, it then multiplies this cost by the number of units in stock to arrive at the total inventory value. Therefore, all items of a particular stock number are valued at the same price, and the resulting value of the inventory is essentially the cost to replace the

items. The Air Force believes that such a standard pricing policy provides the most useful information to Air Force managers because current costs are more pertinent for decisionmaking than historical costs.

To evaluate the implementation of this policy, we randomly selected a sample of 113 items from stock numbers at the three ALCs we visited. We found that Air Force inventory values often did not represent replacement costs as outlined in Air Force policy. Only 47 of the 113 items were priced in accordance with the policy. Of the 66 remaining items, the Air Force priced 22 too high and 44 too low. These variations were caused by numerous factors, including the frequency of recent procurement activity, the extent of price inflation for the items, the age and quantity of inventory on hand, and how well the inventory pricing history system was maintained. Two examples highlight the magnitude of errors possible under the present system:

- A capacitor for aerospace and ground equipment was valued at $10,446. The most recent acquisition costs for this item were $953 and $1,492. Air Force officials were unable to explain this discrepancy.
- A control panel for an F-15 aircraft was valued at $298,075, but the latest acquisition price was $210,342. The item manager said that the system had not been updated to reflect the new price and promised to correct the oversight.

Air Force officials told us that inventory pricing was not a high priority and that our tests confirmed that the Air Force has not effectively implemented its inventory valuation methodology.

Change in Cost Accounting System Is Needed

While the Air Force's use of replacement cost valuation in its cost accounting system has some advantages, the present system does not consider historical costs. As a result, the misleading effects of replacement cost valuations are not considered and the full advantages of a cost system based on replacement costs are not being obtained.

At present, changes in replacement costs distort inventory trend information. Real inventory growth can occur as a result of the increase in the quantities of units of a particular NSN or the procurement of spares for a new weapons system. If replacement costs are used, however, much of the growth in the value of the inventory is due to inflation in the replacement cost of inventories held in stock; this distorts the real picture of inventory growth. It is impossible for users of inventory information to ascertain real growth versus inflation adjustments in the

value of existing stock. We believe all gains or losses in inventory values caused by fluctuations in the valuation process should be reflected separately in the statement of operations and in inventory management reports to isolate this element of inventory change.

To more effectively manage inventory, the Air Force systems need to include the cost of the inventory as well as the cost to replace inventory. Top management needs to have a system which produces information useful in communicating to managers the expectations against which they will be evaluated and held accountable. Such a system should include the following:

- establishing cost centers, such as air wings or air bases, which correspond to activities for which individual managers have responsibility;
- setting of standards against which performance is to be measured, such as budgets, forecasts, cost per unit of measure (aircraft, person, base, etc.);
- accumulating costs at the cost center level;
- reporting systematically the performance against the established standards; and
- consolidating and providing these performance reports to each succeeding level of management.

The effective operation of such a system should provide the capability to manage more effectively by identifying expectations and persons responsible for meeting them. This should result in the ability to contrast performance of managers, more effective budgeting, and more efficient expenditure of the tax dollar.

Other Inventory Weaknesses

Air Force inventory management and control have had long-standing weaknesses. In addition to problems with the accuracy of inventory records and the valuation of the inventories noted above, the Air Force has problems with (1) the effectiveness of research to identify the causes of inventory discrepancies, (2) the physical protection of inventories, and (3) the determination of inventory requirements. While the Air Force has taken steps to improve its inventory control, further improvements are needed, especially in view of the continued inventory growth which is exacerbating the problems in managing inventory. Some of the long-standing problems that we have reported on in recent years are discussed below.

- Inappropriate reversals of high-dollar transactions were made to inventory records in order to avoid management's attention. We found two cases where physical inventories showed differences of $3.8 million and $797,000, respectively, between the perpetual records and the quantities on hand. Subsequent research showed that issue documents caused quantities to be reduced in the records, but the items involved were never shipped. Rather than processing inventory adjustments with appropriate explanations, the issue transactions were removed from the system. While this corrected the quantities in the records, it violated Air Force policy, which states that reversals will not be processed to increase or decrease asset balances in order to correct inventory inaccuracy. More importantly, management was not notified of the corrections and was not aware of this type of problem. We have reported that inappropriate reversals are a long-standing problem at ALCs.[2]
- In cooperation with the Air Force, the Federal Bureau of Investigation has completed an investigation which resulted in indictments against military and civilian personnel for stealing military goods. Stolen equipment, including F-16 engines, sleeping bags, munitions, and firearms, were purchased by FBI agents in a "sting operation" near military bases in the western and southwestern United States.
- The Air Force's statistical sampling and evaluation methodology overstated inventory accuracy because items with zero balances and items with no-location designation were included as correct. We recommended that the Secretary of Defense, in requiring annual statistical samples as the basis for measuring and reporting inventory accuracy, provide that these samples exclude zero-balance items where there is no record of a storage location.[3] However, we observed that the Air Force is continuing this practice.
- Another report[4] disclosed that the Air Force did not adequately consider the cost-effectiveness of terminating contracts for excess on-order material. We found that terminations should be increased, thereby reducing the government's procurement and inventory holding costs and providing a basis for reduced Air Force spare part funding. Recommendations were made to require an emphasis on an effective program, including appropriate management guidance and oversight, for terminating procurements of excess on-order spares when termination is in the best interest of the government.

[2]Inventory Management: Air Force Inventory Accuracy Problems (GAO/NSIAD-88-133, May 12, 1988).

[3]See footnote 2 above.

[4]Military Procurement: Air Force Should Terminate More Contracts for On-Order Excess Spare Parts (GAO/NSIAD-87-141, August 12, 1987).

- We reviewed the Air Force's practices for purchasing recoverable spare parts (spare parts that can be repaired after becoming unserviceable) to determine whether it was buying them at the appropriate time. We reported[3] that, at two of the Air Force's five air logistics centers, recoverable spare parts were regularly bought up to 14 months earlier than necessary. Recommendations were made to the Air Force to require compliance with existing regulations precluding early procurement and to review in-process recoverable spares purchases for opportunities to cancel or delay the purchase.
- We reported[4] the Air Force's price growth and the inadequacy of price analysis in relation to purchases of spare parts. After receiving a draft of the report, Air Force officials issued a letter outlining price analyses pitfalls and citing examples of inadequate price analyses. The letter requested appropriate officials to remind buyers of these pitfalls and to ask buyers to examine their use of price analyses.
- We also have ongoing work addressing the problems causing growth in unrequired inventory not related to increased military capability. The most common causes for this growth are overestimated use rates and modifications of aircraft and equipment. Other causes included faster than expected phase-outs of older aircraft, fluctuating war reserve and safety level requirements, improved item reliability, and items being reclassified as repairable. Also, orders for items in excess of requirements were not terminated and procurement lead times were overestimated. As a result, materials were received sooner than required.

Of the total $29 billion of DOD unrequired inventory, the Air Force part was estimated at $10 billion. This audit confirms that inaccurate records contribute to this condition.

We currently have ongoing work which will address matters related to inventory on a DOD-wide basis.

Conclusions

While the problems in effectively managing the Air Force's huge inventories seem overwhelming, the Air Force has made headway in dealing with some of these long-standing problems. Continued progress is even more critical at present as complex issues arise from budget reductions, the probable reduction of forces overseas, and the related redeployment of large quantities of inventory.

[3]Military Logistics: Buying Spares Too Early Increases Air Force Costs and Budget Outlays (GAO/NSIAD-86-149, August 1, 1986).

[4]Procurement: Spare Parts Initiatives Air Force Implementation (GAO/NSIAD-87-28, February 13, 1987).

The Air Force can more effectively manage inventories by improving the reliability of data used to make managerial decisions. Inaccurate inventory balances can lead to the waste of limited resources. This unnecessary investment in inventories leads to very substantial costs related to stock maintenance, deterioration, and obsolescence. The management benefits from maintaining accurate inventory balances include the abilities to (1) forecast requirements, (2) manage inventories between locations, (3) locate items when needed, (4) identify excess stocks, (5) establish accountability for custody and efficient use of items, and (6) produce reliable inventory valuations for financial reporting.

The sheer magnitude of the inventory not only makes it a challenge to manage but also requires that good inventory management be achieved to promote efficient and effective operations and support the mission of the Air Force.

Recommendations

We recommend that the Secretary of the Air Force emphasize the need to improve the accuracy of perpetual inventory records. In this regard, we are recommending that the Secretary require the Chief Financial Officer to

- establish a policy to value unserviceable items to reflect the estimated costs of repair;
- adopt an improved standard cost accounting system integrated with the general ledger which provides for accurate determination of standard costs based on replacement costs, identification of inflation growth, and variance analysis with respect to purchase prices, material usage, and repair costs; and
- initiate a special effort to reduce the $10 billion of unrequired inventory and deal with the root causes of this problem.

Agency Comments and Our Evaluation

DOD concurred with the recommendations presented above except it is still considering how to value unserviceable items, and it plans to develop a cost accounting system based on its specific needs. This system may be a job order cost system rather than a standard cost system.

Chapter 6

Air Force Financial Management System Improvement Efforts

The previous chapters have discussed financial and accounting deficiencies occurring throughout most aspects of the Air Force's operations. The existing accounting practices and systems do not provide the kinds of financial information needed to manage in a cost-effective manner.

Generally, federal agencies and private sector firms have demonstrated the ability to develop, manage, and operate complex technology successfully, when top management clearly articulates its priorities and commits the resources needed to successfully fulfill the priority. The Air Force has committed resources in developing sophisticated, complex weapons systems, yet its financial management operations are clearly antiquated and even lack one of the most fundamental controls—a general ledger accounting system. Since the Air Force's financial management practices and systems have been deficient over many years, it appears that this area has not been a high priority for either DOD or Air Force leadership. The effort and resources required to deal with these issues in a first-class manner, though formidable, are small when compared to those devoted to achieving the organization's other accomplishments.

> More importantly, the potential efficiencies to be gained through effective financial management would allow the Air Force to better accomplish its primary mission. To illustrate, if one were to consider other uses that could have been made of the $10 billion invested in unrequired inventories in terms of additional flying time for aircraft, the lost benefits resulting from waste and inefficiency become readily apparent. From another perspective, even as expensive as modern military hardware is, $10 billion translates into many fighters, bombers, or missiles. Clearly, neither DOD nor the public can any longer afford the luxury of ignoring the consequences of weak financial management of defense operations.

If cost-effectiveness and efficiency become a priority of Air Force financial management, and thus an important part of the organization's culture, improvements in operations and program management can and will be accomplished. Good financial management and accounting systems provide the foundation for cost-effectiveness and efficiency.

The need for improvement in this area has been demonstrated in many GAO reports, including this one, and is manifested by the poor state of accounting practices and systems in the Air Force. Tens of billions of dollars of costs are not entered into the accounting system and brought under accounting control. The existing financial management systems

are not designed to provide the accountability needed. Chapter 2 points out that the accounting systems do not capture costs as they are incurred. Chapter 3 indicates that controls over costs are weak. Chapters 4 and 5 illustrate major dollar impacts of these conditions on weapons systems and inventories.

When accountability and accurate cost information are not obtained, the following conditions result:

- Financial information needed for management and analysis of Air Force trends is unreliable.
- Operating costs of air wings, bases, depots, and commands cannot be compared and evaluated.
- Losses can occur from fraud, waste, abuse, and mismanagement, yet not be identified and their causes dealt with.
- Inventories cannot be effectively managed to avoid shortages and excessive stocks.
- Cost factors cannot be properly considered when deciding to replace or upgrade existing weapons systems.
- The basis for evaluating procurements and budget requests is not as complete as it might be.

Systems Alternatives for Developing Meaningful Financial Information

The scope of our audit did not include a detailed technical analysis of the Air Force's numerous financial management systems and it is unclear to us whether it would be better to try to upgrade existing systems and develop them as originally intended to achieve an integrated general ledger system or whether it would be better to develop an entirely new system. The poor quality of the present data being generated by or drawn from the existing systems and potentially serious systems interface problems—the exchange of data among related systems—suggest that an entirely new system might be a better alternative. However, developing an entirely new system might take longer to achieve even a reasonable level of improvement than would correcting the present systems. The probable multibillion dollar costs and losses that result from the current lack of accountability and accurate cost information suggest that the decisionmakers should consider, among other factors, the time required to upgrade versus the time required to replace present systems with entirely new ones. It is well beyond the scope of a financial audit to answer this question.

Nonetheless, it is a decision that should be made as quickly as possible by the Secretaries of Defense and the Air Force with the advice of system experts and with a knowledge of Air Force capabilities to execute the decision. This decision should be made in the context of a plan to develop and maintain an integrated Air Force accounting and financial management system, including financial reporting and internal controls, which

- comply with the accounting and financial reporting principles, standards, and requirements, and the internal control standards established by the Comptroller General and with policies and requirements prescribed by the Office of Management and Budget and the Department of the Treasury;
- include complete, reliable, consistent, and timely information which is prepared on a uniform basis and which is responsive to the financial information needs of DOD and Air Force management, including the development and reporting of cost information;
- integrate accounting and budgeting information; and
- provide for the systematic measurement of performance.

Plans to Develop a New Base-Level Accounting System

The Air Force has a project underway to develop a completely new general ledger accounting system for use at its 120 bases. This new system will produce 120 base-level general ledger trial balances, which must then be manually consolidated to obtain an Air Force-wide trial balance. The Air Force expects this system, known as the Base Level Accounting and Reporting System (BLARS), will be operational by 1994.

The Air Force's consultant for this project has advised us that because the General Accounting and Finance System (GAFS) has not been implemented to function effectively as a general ledger accounting system and has interface problems with supporting systems, a completely new general ledger accounting system is preferable to attempting to upgrade GAFS. However, BLARS is dependent on other systems at the bases, such as the supply transactions processed through the Standard Base Supply System, for information on many of the resources. Efforts to improve the other Air Force systems that need to interface with BLARS will be affected by the decisions on BLARS' development. The BLARS project is not being approached in the context of an overall Air Force plan, nor does it consider overall DOD needs. Action to change the culture and make cost-effectiveness the priority of those who will implement and use the BLARS system has not yet occurred. The BLARS requirement and other aspects of the BLARS development may need further review.

As concerned as we are with the need for a quick response to improve the Air Force's financial management system, we believe that these concerns need to be addressed in order for any systems changes to produce meaningful, long-term benefits. Accounting and financial management systems development and major modification efforts require substantial commitments of human and financial resources. The decisions made when these efforts are being planned and carried out will significantly affect the system's future efficiency, its effectiveness in providing the information needed to manage the agency's operations, and its useful life. Historically throughout the federal government, system development efforts have been flawed, suffering from significant cost increases, schedule slippages, performance shortfalls, redirected development and acquisition strategies, and, all too frequently, have failed completely.

Thus, careful, effective planning throughout the entire development process is extremely important. Accordingly, a structured approach to developing new or to modifying existing systems can be viewed as consisting of five major stages: (1) initiation, (2) definition, (3) design, (4) development and testing, and (5) installation.

BLARS Status and Objectives

The Air Force has just completed the system's requirement definition phase of the BLARS project. The ultimate success of the project will depend upon the adequacy of the defined requirements and the successful completion of the other stages of the systems development effort. At present, the system requirements have been identified and a draft request for proposal has been distributed to various Air Force officials for comment. In March 1990, the Air Force plans to request proposals to design, develop, and implement BLARS. Defining the system requirements is only the second step in a long process. Equally difficult and critical stages are yet to come. In short, much remains to be done before the present systems can be replaced or improved. Full implementation by 1994 will be difficult and only possible sooner if it becomes a very high priority for the Air Force.

BLARS Requirements

We have not made a thorough systems analysis, nor have we reviewed the system requirements in detail. Therefore, we express no opinion on the adequacy of the systems requirements. However, some new features included in the BLARS requirements appear to represent significant improvements over the Air Force's present accounting operations. Examples of some of the new features follow:

- A general ledger function at the base level that maintains a chart of accounts, performs automated general ledger posting, and provides summary data for reporting. (See chapter 2.)
- A series of reports comparing actual expenditures to those planned. (See chapter 2.)
- A property accounting subsystem to maintain and update property accounts, including aircraft and missiles, which reflects actual costs. (See chapter 4.)
- The capability to provide payment data directly to the accounting station, bypassing the finance center. At the accounting station, BLARS will verify whether payments have been made correctly. (See chapters 3 and 4.)

The system requirements do not specifically call for a cost accounting system that meets the objectives discussed in chapter 5, a very important requirement in our opinion, nor do they cover program financial systems that carry out unique program and operating functions as well as financial management. Except for a cost accounting system, the systems requirements appear to incorporate existing governmental requirements included in the (1) U.S. Government Standard General Ledger, (2) Core Financial System Requirements and (3) Title 2 of GAO's Policy and Procedures Manual for Guidance of Federal Agencies.

BLARS is intended to be a base level financial accounting and information system. With proper interfaces, it could provide information needed by successively higher levels of command and exchange information with related systems, such as those operated by the Logistics Command. However, the present scope of its requirements only identifies the systems with which such interfaces would be needed, but developing those interfaces and making the changes to the related systems would be required to ensure that internal controls are effectively strengthened and financial management improved. Accordingly, BLARS should not be viewed as fully responsive to the Air Force's need for an integrated, servicewide general ledger system.

Other Comments on the BLARS Development Effort

The Air Force has prepared a draft of the request for proposal (RFP), which will be used to solicit bids for the design and implementation of BLARS. The draft identifies some elements that may help avoid design and development delays during the implementation of BLARS, including incorporating existing off-the-shelf systems or software and adopting an incremental approach to implementation. Incorporating existing systems or software could reduce design and development costs, and more

importantly, the Air Force could get processes already proven to work. An incremental approach can minimize the risks inherent in implementing all modules of the new system at the same time. Moreover, under this approach, users will be able to benefit from individual modules as they become operational. This approach may permit the Air Force to obtain some improvements from BLARS in certain systems before 1994..

In recent years, we have reviewed a number of major federal systems development efforts, including several undertaken by DOD organizations.[1] This work has revealed a disturbing pattern of cost growth, delays, performance shortfalls, and outright failures. These reviews identified similar development efforts that fell short of their objectives. In order to avoid such problems, we believe the planning for BLARS needs to address several additional concerns not specifically addressed in the requirements definition, including

- Direction of the development effort: The Air Force's chief financial officer should be directly responsible for the project. In addition to outside consultants, the chief financial officer should consult with a panel of recognized experts drawn from both the private and public sector, some of whom should have major systems development expertise and others with experience in operating the kinds of systems which might be borrowed by the Air Force.
- Data integrity: As discussed in previous chapters, much of the data currently used by the Air Force are inaccurate and unreliable. Before BLARS is implemented, the historical data will need to be corrected for entry into the system.
- Interface problems: BLARS is designed to rely heavily on many other existing Air Force systems (such as supply, contracting, personnel, and inventory) and on systems external to the Air Force (such as those operated by the Defense Logistics Agency) as a source of data. The Air Force must ensure that the data exchanged between and among these systems are compatible and accurate and enhance financial management.
- Systems changes: A common tendency during the design and development of new systems is to add additional capabilities to the system simply to accommodate user requests to gain their acceptance of the system. The Air Force needs to be certain that requirements are complete and reasonably satisfy the users so that the requirements can be

[1]See our reports entitled, ADP Acquisition: Air Force Logistics System Modernization Projects (GAO/IMTEC-89-42, April 21, 1989) and Automated Information Systems: Schedule Delays and Cost Overruns Plague DOD Systems (GAO/IMTEC-89-36, May 10, 1989).

finalized and serious delays which result from systems changes can be avoided.

- Adequacy of personnel and funds: The common problem of underestimating the total cost of development must be avoided. Realistic estimates should be communicated to DOD and, through the budget process, to the Office of Management and Budget and to the Congress.

Since we did not make a systems needs study nor review the requirements and RFP documents in detail, these comments are not all-inclusive.

Conclusions

Throughout the report, we have made recommendations that will help improve financial management and control over the Air Force's operations. While these measures should improve management control over the next few years, without an effective integrated accounting and financial management system, the Air Force will continue to have incomplete financial data and will not be able to effectively perform financial management. Although BLARS does not represent an effective overall solution to the Air Force's financial systems needs, we believe that the BLARS initiative represents a significant first step for establishing a foundation for ultimately developing a sound financial management system to correct the Air Force's lack of accurate and reliable financial data.

Recommendations

We recommend that the Secretary of the Air Force

- make improving accounting practices and financial management systems an Air Force-wide priority effort, supported by adequate resources;
- direct the chief financial officer to develop a comprehensive plan for improving and integrating the Air Force's financial management and accounting systems;
- review the systems requirements of BLARS and all related systems to ensure that they are complete and that they address all the Air Force's concerns about its operations and the problems addressed in this report; and
- ensure that a project management structure and plan are in place to avoid the potential pitfalls that have caused problems in past systems development efforts. This structure must include adequate representation and participation by top management and functional users in all phases of the development effort.

Agency Comments

DOD concurred with all the recommendations presented above.

Appendix I

Consolidated Financial Statements of the U.S. Air Force for the Fiscal Year Ending September 30, 1988

We attempted to audit the accompanying consolidated statement of financial position of the Department of the Air Force, an agency of the Department of Defense, as of September 30, 1988, and the related consolidated statement of operations for the fiscal year then ended. These financial statements are the responsibility of Air Force management.

GAO is not expressing an opinion on the Air Force's financial statements because of the conditions discussed in this report.

- The Air Force accounting systems do not support a consolidated general ledger. A significant amount of transactions included in the financial statements are not under basic double entry accounting control (chapter 2).
- Material weaknesses in internal controls over the accumulation of financial data ultimately reported in the financial statements prevent reliance on the amounts reported therein (chapter 3).
- The actual cost of military hardware could not be determined. The Air Force reported $117 billion for these assets based on a standard cost rather than a historical cost basis and did not capitalize any modification costs (chapter 4).
- The extent of the overstatement of the $63.8 billion inventories could not be determined. The inventories were valued at standard cost rather than at the lower of cost or market. Also, nearly one third of the inventory was unserviceable but was valued the same as new items (chapter 5).

Consolidated Statement of Financial Position

AS OF SEPTEMBER 30, 1988
(in millions)

	(Unaudited)
Assets:	
Funds with U.S. Treasury (note 1-C)	$ 79,674
Appropriations to be provided (note 1-B)	2,143
Accounts receivable, net (note 3)	
Governmental	967
Public	651
Inventories (note 1-D)	63,762
Property and equipment (notes 1-E, 4):	
Equipment	26,770
Buildings	19,666
Aircraft	82,344
Less accumulated depreciation	(47,090)
Land	252
Other real property	8,832
Missiles	9,921
Construction in progress	1,685
Aircraft under construction	14,925
Missiles under construction	3,276
Uninstalled propulsion units	6,853
Other assets	143
Total Assets	$374,974
Liabilities:	
Accounts payable	
Governmental	$ 892
Public	17,518
Personnel accruals (note 1-F)	
Annual leave	673
Military leave	1,554
Seperation allowance	200
Deposit and trust fund	108
Other	2,299
Total Liabilities	23,244
Equity (note 1-I):	
Invested capital	182,975
Cumulative results of operations	4,772
Unexpended appropriations	
Unobligated balances	15,791
Undelivered orders	49,137
Unfilled orders	(1,145)
Total Equity	251,530
Total Liabilities and Equity	$374,974

The accompanying notes are an integral part of these financial statements. The supplemental schedules in note 10 provide additional details by fund type for the consolidated financial statements.

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Consolidated Statement of Operations

FOR THE YEAR ENDING
SEPTEMBER 30, 1988
(in millions)

	(Unaudited)
Operating Revenues and Financing Sources (note 1-B):	
Appropriations realized	$64,001
Appropriation reimbursements	2,128
Airlift services	993
Depot maintenance	97
Real property maintenance and other revenue	254
Stock fund sales	2,366
Total Operating Revenues and Financing Sources	$69,839
Operating Expenses:	
Military personnel	$19,990
Civilian and foreign national personnel	9,108
Travel and transportation	1,626
Utilities, rents, and communications	1,769
Equipment maintenance	1,104
Purchased services	8,598
Supplies and fuels	717
Research and development (note 1-H)	13,675
Depreciation (note 1-E)	3,593
Aircraft crashes (note 8)	152
Other	1,054
Stock fund cost of sales and expenses	8,693
Total Operating Expenses	$70,079
Excess of Operating Expenses Over Revenues and Financing Sources	$ (240)

The accompanying notes are an integral part of these financial statements. The supplemental schedules in note 10 provide additional details by fund type for the consolidated financial statements.

NOTES TO FINANCIAL STATEMENTS

Note 1: Summary of Significant Accounting Policies

A. Entity and Basis of Consolidation

The United States Air Force was created on September 18, 1947 by the National Security Act of 1947. The National Security Act Amendments of 1949 established the Department of Defense (DOD) and made the Air Force a department within DOD. The overall mission of the Air Force is to organize, train, and equip aerospace forces to deter aggression and, if necessary, defeat aggressors of the United States and its allies.

Fiscal year 1988 represents the first year that the Air Force has prepared consolidated financial statements as required by Title 2 of GAO's Policy and Procedures Manual for Guidance of Federal Agencies (hereinafter referred to as Title 2). Title 2 requires executive agencies to annually issue four consolidated financial statements: (1) statement of financial position, (2) statement of operations, (3) statement of changes in financial position, and (4) statement of reconciliation to budget. As a result of first-year efforts to comply with Title 2 reporting requirements, the Air Force prepared the consolidated statements of financial position and operations for the year ended September 30, 1988.

The accompanying consolidated financial statements account for all funds for which the Air Force is responsible except that information relative to classified assets, programs, and operations has been excluded from the statements or otherwise aggregated and reported in such a manner that it is no longer classified. The consolidated financial statements are presented on the accrual basis of accounting as required by Title 2. A discussion of these funds is included in note 9. The supplemental schedules in note 10 present financial data by fund type.

All significant intra-agency transactions and balances have been eliminated in consolidation. As shown in the following table, significant portions of revenue and expenses, which resulted from intra-agency activities within the Air Force, have been eliminated, including $1,482 million of eliminations within the general funds not shown in the supplemental schedules (note 10).

	(in millions)
Appropriation reimbursements	$ 1,789
Airlift services	691
Depot maintenance	3,448
Stock funds activities	6,129
Total eliminations	$12,057

B. Recognition of Revenue and Financing Sources

Financing sources for general funds are provided through congressional appropriations which are received on both annual and multi-year bases. Currently, the congressional budgetary process under which the Air Force operates does not distinguish between capital and operating expenditures. For budgetary purposes, both are recognized as a use of resources (outlays). For financial reporting purposes under accrual accounting, operating expenses for general fund activities are recognized in the period incurred. Expenditures for capital and other long-term assets are not recognized as expenses until consumed in the Air Force's operations. Unexpended appropriations are recorded as equity of the U.S. government.

Certain expenses, such as annual and military leave earned but not taken, are not funded when accrued. Such expenses are financed in the period in which payment is required. Therefore, for Air Force general funds, an amount due from future financing sources (appropriations to be provided) is recognized as an asset in the consolidated statement of financial position which is comprised of the accrued amount of such expenses at year-end.

The Air Force operates two types of revolving funds, industrial and stock, for the purpose of distributing services and inventories to Air Force and DOD activities. Revenue for industrial fund activities is recognized at the point the rendered service is completed and on a percentage of physical completion basis. Revenue for stock fund activities is recognized at the point the inventory items are sold.

The Air Force performs certain services for other governmental and public entities. These services are initially financed through general funds and subsequently reimbursed by the recipients. Reimbursements are recognized as revenue at the time the services are rendered.

C. Funds with U.S. Treasury

Air Force fund resources are maintained in Treasury accounts. Its cash receipts and disbursements are processed by the Treasury, and the balance with the Treasury represents the aggregate of all unexpended balances. As of September 30, 1988, the Air Force had $49,137 million in funds with the Treasury which were available to pay outstanding obligations.

D. Inventories

Inventories, including operating supplies and non-consumable items, are valued at standard prices established by the Air Force or the Defense Logistics Agency as required by DOD

accounting directives. Generally, these prices are based on prices paid for recently acquired items plus appropriate surcharges. Gains and losses that result from standard price changes for stock fund items are recognized and reported in the statement of operations as miscellaneous revenues or expenses. In 1988, the stock funds recorded a net loss of $39.7 million, while the industrial funds recorded a loss of $2.4 million due to changes in standard prices. No gains or losses are recognized in the consolidated statement of operations as a result of changes in standard prices for general fund inventories. Such changes are reflected in the asset valuations and related invested capital as reported in the statement of financial position.

E. Property, Plant, and Equipment

Valuations for equipment, aircraft, missiles, and engines are not based on historical procurement costs. These assets are valued and reported at standard or average procurement costs in conformance with DOD accounting directives.

Equipment is valued at standard costs which the Air Force establishes using federal stock categories. While no gains or losses are recognized in the statement of operations for changes in standard costs of equipment, such changes are reflected in asset valuations and related invested capital.

Aerospace vehicles (aircraft and missiles) are valued at average procurement costs. Engineering and modification costs incurred subsequent to approval of the basic procurement contracts are not capitalized unless such modifications and engineering changes result in a new category of weapon system commonly referred to as "mission, design, series," or MDS.

Land and facilities are valued at cost. Buildings are capitalized when constructed or at the date of acquisition and are assigned useful lives of 40 years. Building improvements costing more than $5,000 are capitalized and depreciated over the remaining useful life of the building.

Routine maintenance and repair costs are expensed when incurred. Depreciation of property and equipment is calculated on a straight-line basis. Industrial funds record depreciation on buildings and equipment as required by Title 2 for revolving fund activities. While Title 2 does not specifically require depreciation on general fund assets, depreciation is recorded on Air Force's aircraft and buildings. No depreciation has been recorded for other general fund equipment and missiles (see note 4).

F. Accrued Leave

Civilian annual leave and military leave are accrued as earned and the accrued amounts are reduced as leave is taken. The balances for annual and military leave at the end of the fiscal year reflect current pay rates for the leave that is earned but not taken. Sick and other types of leave are expensed as taken.

G. Foreign Currency Transactions

The Air Force conducts a significant portion of its operations overseas. Gains and losses from foreign currency transactions for four general fund appropriations (Air Force operation and maintenance, Air Force construction, family housing operation and maintenance, and family housing construction) are recognized and reported in the statement of operations. The gains or losses are computed as the variance between the current exchange rate at the date of payment and a standard exchange rate established at the beginning of the fiscal year. In fiscal year 1988, the Air Force recognized a net loss of $477 million due to foreign currency transactions for the four appropriations. Similar gains and losses for other appropriations are not recognized in the statement of operations. They are absorbed by budgetary transactions in which obligations are increased or decreased to reflect foreign currency fluctuations.

H. Research, Development, Testing, and Evaluation Costs

The Air Force conducts and contracts for research, development, testing, and evaluation (RDT&E) of advanced aerospace systems. RDT&E costs are expensed as incurred. In fiscal year 1988, the Air Force incurred RDT&E costs of $13,675 million, of which $962 million was for reimbursable work performed for other entities.

RDT&E programs support modernization of weapon systems through military research, exploratory development, and the development and testing of prototypes and full-scale preproduction of hardware. The Air Force contracts for and procures its weapons systems considering the technological advances achieved through RDT&E programs.

I. Equity

Equity consists of invested capital, cumulative results of operations, and unexpended appropriations. Invested capital, as presented in the consolidated statement of financial position, represents the value of the Air Force's capital assets as reported at standard prices/costs, except for land and buildings. The portion of invested capital attributable to land and buildings represents their undepreciated cost.

Increases to invested capital are recorded when capital assets are acquired or constructed or when asset valuations increase as a result of increases in standard prices/costs. Decreases occur as capital assets are depreciated or consumed in operations, or when standard prices/costs are decreased. Donated capital and trust fund balances, while immaterial to the Air Force's overall financial position, have been included in invested capital.

Cumulative results of operations - working capital funds represents the excess of revenues over expenses since fund inception, less refunds to customers and returns to the U.S. Treasury.

Unexpended appropriations represent amounts of authority which are unobligated and have not been rescinded or withdrawn, and amounts obligated but for which neither legal liabilities for payments have been incurred nor actual payments made.

Note 2. Accounting for Intragovernmental Activities

The Department of the Air Force, as an agency of the Department of Defense and the federal government, interacts with and is dependent upon the financial activities of the federal government as a whole. Therefore, these financial statements do not reflect the results of all financial decisions applicable to the Air Force as though the agency were a stand-alone entity.

A. The Air Force's proportionate share of public debt and related expenses of the federal government are not included. Debt issued by the federal government and the related interest costs are not apportioned to federal agencies. The Air Force's financial statements, therefore, do not report any portion of the public debt or interest thereon, nor do the statements report the source of public financing whether from issuance of debt or tax revenues.

B. Financing for the construction of Air Force facilities was obtained through budget appropriations. To the extent this financing may have been ultimately obtained through the issuance of public debt, no interest costs, thereon, have been capitalized since the Treasury does not allocate such borrowings to the benefitting agencies.

C. The Air Force's civilian employees participate in the Civil Service Retirement System (CSRS) and Federal Employees Retirement System (FERS) while military personnel are covered by the Military Retirement System (MRS). Additionally, employees and personnel covered by FERS and MRS are also covered by Social Security. The Air Force funds a portion of pension benefits under these retirement systems but does not disclose the assets or actuarial data on the accumulated plan benefits or unfunded pension liabilities of its employees.

Reporting such amounts is the responsibility of the Office of Personnel Management for CSRS and FERS and the Department of Defense for MRS. In fiscal year 1988, the Air Force contributed the following amounts to the retirement plans and Social Security.

	(in millions)
CSRS	$ 337
FERS	158
MRS	5,287
Social Security	1,085
	$[illegible]

The Air Force also contributed $30 million to the FERS Thrift Savings Plan on behalf of its participating employees.

D. Certain legal actions to which the Air Force may be a named party are administered and, in some instances litigated, by other federal agencies. Legal actions to which the Air Force is a litigant are covered by the Federal Tort Claims Act and Chapter 163 (military claims) of Title 10, United States Code. Air Force contingent liabilities under the Tort Claims Act and Chapter 163, 10 U.S.C, are $2,500 and $100,000, respectively, per occurrence. Settlements in excess of these amounts are paid from the Treasury's Claims, Judgments and Relief Acts Fund. Thus, most contingent liabilities arising from legal actions against the Air Force will not materially affect its operations or financial condition. (See note 7.)

E. In fiscal year 1988, the Air Force sold assets to foreign governments under the provisions of the Arms Export Control Act of 1976. Under the provisions of the act, DOD has authority to sell defense articles and services to foreign countries, generally at no profit or loss to the U.S. government. Customers are required to make payments in advance to a trust fund maintained by the Department of the Treasury from which the military services are reimbursed for the cost of administering and executing the sales. In fiscal year 1988, the Air Force received reimbursements of $565 million for assets and services sold under the Foreign Military Sales program.

F. Certain Air Force contracts are administered by other DOD entities. Generally, the Air Force administers its high-dollar-value prime contracts for acquisitions of weapon systems. Other contracts are administered by the Defense Contract Administration Services (DCAS), Army, or Navy. Under the provisions of inter-service agreements, these entities make disbursements of Air Force funds to contractors in accordance with contract terms and provide financial data to the Air Force. Additionally, the State Department disbursed over $1,024 million of Air Force funds in fiscal year 1988, primarily to reimburse foreign governments for the cost of

fuels provided for Air Force aircraft. The following amounts of disbursements of Air Force funds were made by these entities in fiscal year 1988.

	(in millions)
DCAS	$13,569
Army	11,686
Navy	1,359
State	1,024
	$[illegible]

Note 3. Accounts Receivable

As presented in the consolidated statement of financial position, accounts receivable include accounts, claims, and refunds receivable and advance payments to other entities. Allowances for uncollectible accounts are based upon analysis of collection experience by fund type.

	Amount	Allowance (in millions)	Total net
Accounts receivable			
Government	$ 824	$ 2	$ 822
Public	144	8	136
Refunds	258	0	258
Claims	33	0	33
Advance payments	369	0	369
Total	$[illegible]	$[illegible]	$[illegible]

During fiscal year 1988, the Air Force wrote off approximately $24 million in uncollectible receivables.

Note 4. Property and Equipment

Depreciation is recorded for industrial fund equipment and buildings whereas depreciation is recorded only for aircraft and buildings within the general funds. Buildings are assigned useful lives of 40 years, and depreciation is calculated by the straight-line method. Aircraft are assigned useful lives of 20 years and also depreciated on a straight-line basis exclusive of 5 percent residual values. Depreciation of aircraft is based on the vehicles' recorded values using average procurement costs (see note 1-E).

Book values for the Air Force's depreciated assets are shown below.

	Recorded value	Accumulated depreciation	Book value
		(in millions)	
Equipment, industrial funds	$ 1,834	$ 721	$ 1,113
Buildings	19,666	10,295	9,371
Aircraft	82,344	36,074	46,270
	$103,844	$47,090	$56,754

Under provisions of the Intermediate-Range Nuclear Forces Treaty (INF Treaty) signed by the United States and the Union of Soviet Socialist Republics in December 1987, the Air Force's inventory of ground launched cruise missiles is to be destroyed by May 31, 1991. Total value of these missiles is $658 million.

Note 5. Treaties for Use of Foreign Bases

The Air Force has the use of land, buildings, and other facilities which are located overseas and have been obtained through various international treaties and agreements negotiated by the Department of State. Generally, treaty terms allow the Air Force continued use of these properties until the treaties expire. Capital investments in buildings and other facilities (for example, runways) located on the overseas bases are capitalized as stipulated in note 1-E. The fiscal year 1988 consolidated statement of financial position includes $3,701 million of buildings and facilities located in foreign countries. These fixed assets are subject to loss in the event treaties are not renewed or other agreements are not reached which allow for the continued use by the Air Force. Therefore, in the event treaties or other agreements are terminated whereby use of foreign bases is no longer allowed, losses will be recorded for the value of any non-retrievable capital assets.

As of September 30, 1988, two overseas bases, Torrejon, Spain, and Hellinikon, Greece, are planned to be closed within 3 years. Negotiations are anticipated within the year with the cognizant governments regarding possible closure of the bases. Funding for closing and relocation costs will be provided through future Air Force appropriations and North Atlantic Treaty Organization (NATO) funding. As of September 30, 1988, the Air Force had not finalized cost estimates regarding closing these bases and relocating their activities to other bases. Operating expenses for overseas bases are included in the consolidated statement of operations.

Note 6. Leases

As of September 30, 1988, the Air Force was committed to numerous operating leases and rental agreements. Generally, these leases

and agreements were for rental of equipment, space, and operating facilities.

The Air Force owns substantially all of the facilities and real property used in its domestic operations, and capital assets overseas are capitalized similar to domestic assets. Since most of the leases entered into by the Air Force are operating in nature, rather than capital, no capital leases are recognized in the consolidated statement of financial position.

Note 7. Obligations and Contingencies

The Air Force is obligated for goods and services which have been ordered but not yet received (undelivered orders) as of September 30, 1988. Aggregate undelivered orders amounted to $49,137 million at September 30, 1988. Of this amount, $28,184 million relates to contracts for the construction and delivery of aerospace vehicles.

The Air Force is a party to various legal and administrative actions and claims brought against it. These relate primarily to tort claims resulting from aircraft and vehicle accidents, medical malpractice, property and environmental damages resulting from Air Force activities, and contract disputes.

Legal claims against the Air Force are adjudicated under two federal statutes, the Federal Tort Claims Act and 10 U.S.C., Chapter 163 (for military claims). As discussed under note 2-D, the Air Force's liability for claims made under the Federal Tort Claims Act is limited to $2,500. Settlements and awards in excess of $2,500 are paid from the Claims, Judgments and Relief Acts fund maintained by the Department of Treasury. Under 10 U.S.C., Chapter 163, the Air Force is liable for payment of awards and settlements up to $100,000 resulting from damages to real and personal property and personal injury or death caused by Air Force activities within the United States and its territories. The Air Force is liable for similar awards and settlements in certain foreign countries resulting from DOD activities. Awards and settlements in excess of $100,000, foreign and domestic, are paid from the Claims, Judgments and Relief Acts fund.

Air Force payments during fiscal year 1988 for awards, compromises, and settlements resulting from such legal actions amounted to $14 million. General Counsel estimates that payments arising from legal and administrative claims outstanding at September 30, 1988, will approximate $22 million in fiscal year 1989. In the opinion of Air Force management and legal counsel, the ultimate resolution of legal actions still pending will not materially affect the agency's operations or financial position. Therefore, no contingent liabilities have been recognized in the consolidated statement of financial position.

As of January 1989, the Air Force was a party to 538 contract appeals before the Armed Services Board of Contract Appeals. Total value of these appeals was $469 million. According to management, approximately 80 percent of appeals are successfully defended by the Air Force. In fiscal year 1988, contractors recovered about $38 million from resolved claims. Such claims are funded primarily from Air Force appropriations.

Additionally, the Air Force is a defendant in a patent infringement lawsuit filed by an aircraft manufacturer. The Air Force's general counsel expects that the suit will be decided in favor of the manufacturer and that the Air Force will eventually pay for damages. Funding for these damages is expected to be derived through future appropriations.

Note 8. Aircraft Crashes

An operating loss of $152 million has been recognized in fiscal year 1988 for aircraft which were either destroyed or damaged beyond repair due to aviation mishaps. The loss represents the book value at unit costs (see note 1-E) of those aircraft either destroyed or damaged. No loss has been separately recognized for aircraft which were damaged by accidents but were reparable. Costs associated with repair of such aircraft are recorded as operating expenses and generally funded from operation and maintenance appropriations.

Note 9. Major Activities/Funds

The Air Force's major activities consist of general, working capital (stock and industrial), trust, special, and deposit funds. General funds are used to record financial transactions arising under congressional appropriations. Air Force manages 15 general fund accounts: 7 are funded by current year appropriations and 8 by multi-year appropriations. These 15 funds received budget authority of $95,137 million in fiscal year 1988, of which the current year appropriations received $64,876 million.

The Air Force's working capital funds finance industrial and commercial type transactions. The stock fund is composed of six divisions: fuels, commissary, general support, systems support, medical/dental, and the Academy store. The stock fund provides supplies and inventories to Air Force organizations on a commercial basis. Receipts derived from stock fund operations are normally available in their entirety for use without further congressional action. In fiscal year 1988, the stock fund recorded an operating deficit of $207 million.

Stock fund sales, costs of sales and expenses, and net operating results by division

Division	Sales	Cost of sales and expenses	Net operating results
		(in millions)	
Fuels	$2,894	$2,937	$(43)
Commissary	2,460	2,457	3
General support	2,091	2,069	22
Systems support	714	909	(195)
Medical/dental	329	324	5
Academy store	7	6	1
Total	$8,495	$8,702	($207)

Amounts shown are before intra-agency eliminations (see supplemental schedules in note 10).

The industrial fund is composed of four divisions: airlift services, depot maintenance, laundry/dry cleaning, and real property. These divisions provide services to other Air Force entities through buyer-seller relationships. Airlift and depot maintenance comprise the most significant portion of industrial fund activity accounting for 95 percent of total industrial fund revenues in fiscal year 1988. The industrial fund recorded an operating deficit of $93 million in fiscal year 1988.

Industrial fund revenues, expenses, and net operating results by division

Division	Revenues	Expenses	Net operating results
		(in millions)	
Real property maintenance, laundry/dry cleaning	$ 254	$ 243	$11
Airlift services	1,684	1,773	(89)
Depot maintenance	3,553	3,568	(15)
Total	$5,491	$5,584	($93)

Amounts shown are before intra-agency eliminations (see supplemental schedules in note 10).

Special funds account for receipts of the government that are earmarked for a specific purpose. The Air Force manages two special funds, the Wildlife Conservation Fund and the Military Assistance Program.

Deposit fund accounts are generally used to (1) hold assets for which the Air Force is acting as agent or custodian or whose distribution awaits legal determination or (2) account for unidentified remittances. The Air Force maintains 31 deposit funds.

Air Force trust funds account for gifts and bequests limited to specific purposes by the donor and/or assets held for particular purposes. The Air Force Revolving Trust Fund, Commissary Stores Surcharge Collections, is the most significant of these and was established to reimburse appropriations for payments made on behalf of commissary stores for operating equipment and supplies, utilities, laundry services, and inventory losses. Surcharges provide revenue which is used to construct commissaries.

Note 10. Supplemental Schedules

The supplemental schedules present the financial position and results of operations by funds. Descriptions of these funds are presented in note 9.

Schedule of Assets, Liabilities, and Equity by Fund Type
(Dollars in millions)

	General funds	Stock funds	Industrial funds	Trust funds	Special funds	Deposit funds	Intra-agency eliminations	Consolidated all funds
Assets								
Funds with U.S. Treasury	$ 78,738	$ 434	$ 333	$ 49	$16	$108	$ 0	$ 79,674
Appropriations to be provided	2,143	0	0	0	0	0	0	2,143
Accounts receivable, net								
Governmental	682	756	498	3	0	0	(932)	987
Public	482	54	108	9	0	0	0	651
Inventories	54,411	88,279	1,072	0	0	0	0	63,762
Property and equipment								
Equipment	24,801	0	1,854	135	0	0	0	28,790
Buildings	19,249	0	417	0	0	0	0	19,666
Other real property	8,720	0	12	0	0	0	0	8,832
Aircraft	82,364	0	0	0	0	0	0	82,364
Missiles	9,921	0	0	0	0	0	0	9,921
Less accumulated depreciation	(46,139)	0	(951)	0	0	0	0	(47,090)
Land	252	0	0	0	0	0	0	252
Construction in progress	1,423	0	13	249	0	0	0	1,685
Aircraft under construction	14,925	0	0	0	0	0	0	14,925
Missiles under construction	3,276	0	0	0	0	0	0	3,276
Uninstalled propulsion units	6,853	0	0	0	0	0	0	6,853
Other assets	2	141	0	0	0	0	0	143
Total assets	$262,183	$89,664	$3,356	$441	$16	$108	$(932)	$274,774
Liabilities								
Accounts payable								
Governmental	$ 1,477	$ 103	$ 160	$ 1	$ 3	$ 0	$(932)	$ 692
Public	16,729	713	69	2	5	0	0	17,518
Personnel accruals								
Annual leave	588	0	85	0	0	0	0	673
Military leave	1,594	0	0	0	0	0	0	1,594
Separation allowance	189	0	11	0	0	0	0	200
Deposit and trust fund	0	0	0	0	0	108	0	108
Other	637	52	1,580	0	0	0	0	2,291
Total liabilities	$ 21,174	$ 978	$1,905	$ 3	$ 8	$108	$(932)	$ 23,264
Equity								
Invested capital	$177,248	$4,388	$1,381	$ (2)	$ 0	$ 0	$ 0	$182,975
Cumulative results of operations	0	4,318	28	426	0	0	0	4,772
Unexpended appropriations								
Unobligated balances	15,776	0	0	14	1	0	0	15,791
Undelivered orders	48,130	0	0	0	7	0	0	48,137
Unfilled orders	(1,145)	0	0	0	0	0	0	(1,145)
Total equity	$241,009	$8,686	$1,389	$438	$ 8	$ 0	$ 0	$251,530
Total liabilities and equity	$262,183	$9,664	$3,294	$441	$16	$108	$(932)	$274,774

Statement of Operations, Financing Sources, and Balances by Fund Type
(Dollars in millions)

	General Funds	Stock Funds	Industrial Funds	Trust Funds	Special Funds	Deposit Funds	Intragovernmental Eliminations	Consolidated All Funds
Operating revenues and financing sources								
Appropriations realized	$53,195	$ 0	$ 0	$ 1	$96	$0	$ 0	$54,031
Appropriations reimbursements	2,271	0	0	166	0	0	(307)	2,130
Permit services	0	0	1,684	0	0	0	(684)	100
Depot maintenance	0	0	3,548	0	0	0	(3,448)	97
Real property maintenance and other revenue	0	0	254	0	0	0	0	254
Stock fund sales	0	6,438	0	0	0	0	(6,129)	7,309
Total Operating Revenue and Financing Sources	$55,267	$6,438	$5,486	$168	$96	$0	$(10,779)	$56,699
Operating expenses								
Military personnel	$19,980	$ 0	$ 0	$ 0	$ 0	$0	$ 0	$19,980
Civilian and foreign national personnel	6,553	0	2,569	0	0	0	(52)	9,110
Travel and transportation	2,223	0	64	0	0	0	(681)	1,606
Utilities, rents, communications	1,648	0	135	0	0	0	(12)	1,780
Equipment maintenance	3,609	0	1,020	0	0	0	(3,799)	1,104
Purchased services	6,198	0	0	0	0	0	0	6,198
Supplies and fuels	5,034	0	1,466	0	0	0	(5,713)	787
Research and development	13,854	0	0	0	0	0	(1,499)	13,675
Depreciation	3,480	0	113	0	0	0	0	3,593
Aircraft crashes	152	0	0	0	0	0	0	152
Other	1,109	0	298	168	16	0	(384)	1,204
Stock fund cost of sales and expenses	0	6,702	0	0	0	0	(19)	6,683
Total Operating Expenses	$63,247	$6,702	$5,764	$168	$96	$0	$(10,573)	$55,004
Excess (Deficit) of Operating Revenues and Financing Sources Over Expenses	$ 0	$ (227)	$ (183)	$ 0	$ 0	$0	$ 0	$ (240)

Appendix II

Comparisons Between Air Force Financial Statements and Treasury Reports

U.S. AIR FORCE COMPARISON BETWEEN
CONSOLIDATED STATEMENT OF FINANCIAL POSITION
AND TREASURY REPORT ON FINANCIAL POSITION
AS OF SEPTEMBER 30, 1988

	Consolidated statement	Treasury report
	(dollars in billions)	
Assets:		
Funds With U. S. Treasury	$ 79.7	$ 79.7
Appropriations to be provided	2.1	
Accounts receivable, net[a]		
Governmental	1.0	2.2
Public	.7	.8
Inventories	63.8	74.2
Property and Equipment:		
Equipment	26.8	25.5
Buildings	19.7	27.3
Aircraft and Missiles	92.2	97.1
Less accumulated depreciation	(47.1)	
Land	.3	.2
Other real property	8.8	
Construction in progress	1.7	1.6
Aircraft under construction	14.9	
Missiles under construction	3.3	
Uninstalled propulsion units	6.9	
Other assets	.1	
Total Assets	$374.3	$381.1
Liabilities:		
Accounts payable		
Governmental	$ .9	$ 13.9
Public	17.5	5.0
Personnel accruals		
Annual leave	.7	.6
Military leave	1.6	
Accrued payroll	0	.9
Separation allowance	.2	
Deposit and trust fund	.1	.1
Other	2.3	1.1
Total Liabilities	23.3	21.6
Equity:		
Invested capital	183.0	221.1
Cumulative results of operations	4.8	4.3
Unexpended appropriations	63.8	61.6
Total Equity	251.6	287.0
TOTAL Liabilities and Equity	$374.3	$381.1

[a]These amounts include advances and prepayments which are shown as separate line items in the Treasury Report.

U.S. AIR FORCE
CONSOLIDATED STATEMENT OF OPERATIONS
AND TREASURY REPORT ON OPERATIONS
FOR THE YEAR ENDING
SEPTEMBER 30, 1988

	Consolidated statement	Treasury report
	(Dollars in billions)	
Operating Revenues and Financing Sources:		
Appropriations realized	$ 64.0	$ 94.4
Appropriation reimbursements	2.1	
Airlift services	1.0	
Depot maintenance	0.1	5.5[a]
Real property maintenance and other revenue	0.2	0.2
Stock fund sales	2.4	9.0
Total Operating Revenues and Financing Sources	69.8	$109.1
Operating Expenses:		80.2
Military personnel	$ 20.0	
Civilian and foreign national personnel	9.1	
Travel and transportation	1.6	
Utilities, rents, and communications	1.8	
Equipment maintenance	1.1	
Purchased services	8.6	5.6
Supplies and fuels	0.7	
Research and development	13.7	
Depreciation	3.6	
Aircraft crashes	0.1	
Other	1.0	
Stock fund cost of sales and expenses	8.7	8.7
Total Operating Expenses	$70.0	$ 94.5
Net Operating Results	$(0.2)	$(14.6)
Less: Capital Expenditure	0.0	18.6
Excess of Operating Expenses Over Revenues and Financing Sources	$(0.2)	$ (4.0)

[a]This amount represents total industrial funds (i.e., airlift services, depot maintenance, real property maintenance and other).

Appendix III

Objectives, Scope, and Methodology

During fiscal year 1988, the Air Force developed its first set of consolidated financial statements for external use. We coordinated with the Air Force throughout this effort by providing technical assistance in developing the statements and footnote disclosures. We also reviewed the accounts that comprise the financial statements and reviewed the Air Force's financial management operations. As a result of our review, we identified issues that need to be resolved not only to enable the Air Force to prepare accurate financial statements but also to improve its accountability and financial management. This was the first comprehensive assessment of the Air Force's financial management operations and, without a doubt, the largest, and arguably, the most complex audit ever undertaken.

Our specific objectives for this review were to:

- develop an understanding of the Air Force's internal control environment;
- identify and document the internal controls, both manual and automated, that relate to recording, processing, summarizing, and reporting financial data;
- identify and document the information streams of financial transactions from inception of a transaction to the reporting of the information to the Finance Center;
- evaluate the adequacy and effectiveness of significant internal accounting controls; and
- test events, transactions, or account balances to substantiate their accuracy, completeness, and propriety.

This review included coverage of the Air Force's financial management operations and accountability for the primary resources—personnel, facilities, inventory, and equipment—it uses to accomplish its mission. We reviewed the Air Force's policies relating to its organization, accountability procedures, and financial management. We also considered previous reports by GAO, Air Force Audit Agency, Department of Defense Office of the Inspector General, and Air Force pursuant to the Federal Managers' Financial Integrity Act. We discussed financial management operations and accountability procedures, functions, and processes with managers throughout the Air Force. We identified internal controls in the accounting systems and operations for the primary resources. Our audit tests focused on the key internal controls specifically related to financial management and accountability for resources.

Field work was performed at the following locations:

- Air Force headquarters, Washington, D.C.;
- Air Force Accounting and Finance Center, Lowry Air Force Base, Denver, Colorado;
- Air Force Systems Command Headquarters, Andrews Air Force Base, Maryland;
- Aeronautical Systems Division, Wright-Patterson Air Force Base, Ohio;
- Space Systems Division, Los Angeles Air Force Station, California;
- Electronic Systems Division, Hanscom Air Force Base, Massachusetts;
- Contract Management Division, Kirtland Air Force Base, New Mexico;
- Air Force Wright Research and Development Center, Wright-Patterson Air Force Base, Ohio;
- Rome Air Development Center, Griffiss Air Force Base, New York;
- 4950th Test Wing, Wright-Patterson Air Force Base, Ohio;
- Air Force Office of Scientific Research, Bolling Air Force Base, Washington, D.C.;
- Air Force Logistics Command Headquarters, Wright-Patterson Air Force Base, Ohio;
- Ogden Air Logistics Center, Hill Air Force Base, Utah;
- San Antonio Air Logistics Center, Kelly Air Force Base, Texas;
- Warner Robins Air Logistics Center, Robins Air Force Base, Georgia;
- Oklahoma City Air Logistics Center, Oklahoma;
- Randolph Air Force Base, Texas;
- Wurtsmith Air Force Base, Michigan;
- Nellis Air Force Base, Nevada;
- MacDill Air Force Base, Florida;
- Langley Air Force Base, Virginia;
- Griffiss Air Force Base, New York;
- Sembach Air Base, West Germany;
- Royal Air Force Lakenheath, England;
- Hickam Air Force Base, Hawaii;
- Kadena Air Base, Japan;
- Andrews Air Force Base, Maryland;
- Air Force District of Washington, Bolling Air Force Base, Washington, D.C.;
- Tactical Air Command Headquarters, Langley Air Force Base, Virginia;
- Strategic Air Command Headquarters, Offutt Air Force Base, Nebraska;
- Air Training Command Headquarters, Randolph Air Force Base, Texas;
- United States Air Forces in Europe, Ramstein Air Base, West Germany;
- Pacific Air Forces, Hickam Air Force Base, Hawaii;
- Military Airlift Command Headquarters, Scott Air Force Base, Illinois;
- Dover Air Force Base, Delaware;
- Travis Air Force Base, California; and
- Rhein-Main Air Base, West Germany.

Appendix IV

Comments From the Department of Defense

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

COMPTROLLER OF THE DEPARTMENT OF DEFENSE

WASHINGTON, DC 20301-1100

FEB 21 1990

Mr. Donald H. Chapin
Assistant Comptroller General
Accounting and Financial Management Division
U.S. General Accounting Office
Washington, DC 29548-0001

Dear Mr. Chapin:

See comment 1

This is the Department of Defense (DoD) response to the GAO draft report "FINANCIAL MANAGEMENT: Billion-dollar Decisions Made Using Inaccurate and Unreliable Air Force Data," dated February 1, 1990 (GAO Code 917118/OSD Case 8193-A).

See comment 2

The Department is concerned that the report may mislead some readers into thinking that the Air Force has misstated the cost of its aircraft or other programs to the Congress. Accurate costs are reported to the Congress for weapon systems through the Selected Acquisition Report data, as well as annually in the Procurement, Research and Development, and Construction appendices to the President's Budget. The DoD is aware that the Air Force accounting system, including financial controls over inventories and Government furnished property provided to contractors, needs improvement.

See comment 3

The Defense Management Report embodies several major initiatives that specifically address the problems identified in the report. These initiatives include major efforts to improve accounting and material management systems and operations. In addition, the Department has recently made several major policy changes to improve the management of inventories and equipment. Several of these initiatives are incorporated in the FY 1991 budget request recently submitted to the Congress. Implementation of these policy changes and initiatives will resolve the problems cited in the report.

The Department emphasizes that the Air Force has demonstrated its interest in enhancing its accounting efforts by its willingness to prepare the prototype reports solicited by the GAO. Notwithstanding the draft report contents, the Air Force continues to seek appropriate improvements, where warranted. The DoD will endeavor to make accounting and reporting data more consistent in future reports.

The DoD responses to the recommendations are enclosed. Unfortunately, due to the short time available for providing comments, the Department was unable to provide its usual comprehensive response, including the milestone/completion dates for the corrective actions. A comprehensive response will be provided on the final report. The DoD appreciates the opportunity to comment on this draft report.

Cordially,

Sean O'Keefe
Comptroller

Enclosure

Don —

Also enclosed is the FY 91 budget justification material which specifically addresses the Department's financial management initiatives stemming from the Secretary's Defense Management Report to the President. Through these initiatives we intend to get after precisely the issues raised in your findings.

GAO DRAFT REPORT - DATED FEBRUARY 1, 1990
(GAO CODE 917118) OSD CASE 8193-A

"FINANCIAL MANAGEMENT: BILLION-DOLLAR DECISIONS MADE USING INACCURATE AND UNRELIABLE AIR FORCE DATA"

DEPARTMENT OF DEFENSE COMMENTS

* * * * *

RECOMMENDATIONS

* * * * *

See comment 4

- Recommendation No. 1: The GAO recommended that the Secretary of the Air Force develop an overall plan specifying corrective actions and milestones for the Air Force to produce consolidated financial statements in accordance with Title 2 that will be submitted to us for audit.

DoD Response: Partially Concur. The Air Force will be required to develop a plan for taking appropriate corrective actions needed to adhere to required Executive Branch financial statement requirements.

See comment 4

- Recommendation No. 2: The GAO recommended that the Secretary of the Air Force give high priority to developing an integrated accounting system capable of generating reliable financial management reports on a timely basis.

DoD Response: Partially Concur. A Defense Management Report initiative provides for the development of DoD-wide financial management functional requirements. This initiative enjoys a high DoD priority.

See comment 4

- Recommendation No. 3: The GAO recommended that the Secretary of the Air Force develop management reports designed to assist to achieve cost-effectiveness and efficiency.

DoD Response: Partially Concur. A Defense Management Report initiative provides for the development of DoD-wide financial management functional requirements.

- Recommendation No. 4: The GAO recommended that the Secretary of the Air Force direct his Chief Financial Officer to correct deficiencies identified in existing systems to the fullest extent possible.

DoD Response: Concur. Requirements currently exist in the Air Force requiring correction of these deficiencies. The Air Force will reemphasize these requirements.

- Recommendation No. 5. The GAO recommended that the Secretary of the Air Force direct his Chief Financial Officer to investigate unusual and abnormal account balances.

DoD Response: Concur. Requirements currently exist in the Air Force for the investigation of unusual and abnormal account balances. The Air Force will reemphasize these requirements.

- Recommendation No. 6: The GAO recommended that the Secretary of the Air Force direct his Chief Financial Officer to perform a periodic comparative analysis of account balances from one period to the next and follow up and explain significant variances.

DoD Response: Concur. Requirements currently exist in the Air Force requiring periodic comparative analysis of account balances. The Air Force will reemphasize these requirements.

- Recommendation No. 7: The GAO recommended that the Secretary of the Air Force direct his Chief Financial Officer to perform, to the fullest extent possible in light of existing systems deficiencies, comparative analyses of operating units across time periods and of other cost centers to determine efficiency of operations.

DoD Response: Concur. Requirements currently exist in the Air Force requiring comparative analyses to determine efficiency of operations. The Air Force will reemphasize these requirements.

- Recommendation No. 8. The GAO recommended that the Secretary of the Air Force direct his Chief Financial Officer to accumulate and report actual costs of equipment in accordance with Title 2.

See comment 4

DoD Response: Partially Concur. A Defense Management Report initiative provides for the development of DoD-wide financial management functional requirements.

- Recommendation No. 9: The GAO recommended that the Secretary of the Air Force direct his Chief Financial Officer to generate more reliable and complete financial information for reports to the Department of the Treasury and for annual consolidated financial statements.

DoD Response: Concur. Appropriate action will be initiated consistent with Executive Branch requirements.

- Recommendation No. 10: The GAO recommended that the Secretary of the Air Force direct the Chief Financial Officer to report the internal control problems with reconciliations and documentation for adjustments in Federal Managers' Financial Integrity Act reports to the Secretary of Defense.

  DoD Response: Concur. Appropriate material weaknesses in internal controls will be identified in future Air Force Federal Managers' Financial Integrity Act reports.

- Recommendation No. 11: The GAO recommended that the Secretary of the Air Force direct the Chief Financial Officer to reconcile subsidiary records periodically to the control accounts and correct errors and weaknesses.

  DoD Response: Concur. Current DoD accounting policies require periodic reconciliations. Incidents cited by the GAO represent instances of noncompliance with these policies. Appropriate corrective action will be directed.

- Recommendation No. 12: The GAO recommended that the Secretary of the Air Force direct the Chief Financial Officer to reconcile disbursements with obligations and promptly correct errors.

  DoD Response: Concur. The most significant problems exist when payments are made for the Air Force by others. Solutions to these problems are being aggressively pursued as a result of the Defense Management Report initiatives.

- Recommendation No. 13: The GAO recommended that the Secretary of the Air Force direct the Chief Financial Officer to document all adjustments to subsidiary records and control accounts.

  DoD Response. Concur. Air Force directives currently require documentation for adjustments to subsidiary records and control accounts. These requirements are not being followed in all cases. This results in a compliance problem requiring increased management attention. The Defense Management Report initiatives are also expected to help resolve such problems.

- Recommendation No. 14: The GAO recommended that the Secretary of the Air Force direct the Chief Financial Officer to enforce Air Force's requirement that supervisors and managers review and approve all significant adjustments.

  DoD Response: Concur. The need for adjustments to be reviewed and approved will receive greater emphasis.

- Recommendation No. 15: The GAO recommended that the Secretary of the Air Force direct the Chief Financial Officer to report unsupported adjustments and reconciliation internal control problems, if applicable, in future Federal Managers' Financial Integrity Act reports.

  DoD Response: Concur. Appropriate material weaknesses in internal controls will be identified in future Air Force Federal Managers' Financial Integrity Act reports.

- Recommendation No. 16: The GAO recommended that the Secretary of the Air Force direct the Chief Financial Officer to accumulate and report actual costs of weapons systems, which include acquisition costs, Government furnished material, operating and maintenance costs, and modifications.

  DoD Response: Concur. Appropriate action will be initiated consistent with Executive Branch requirements. It should be noted, however, that the cost data required to meet congressional requirements for Air Force weapons systems is currently being obtained from sources other than the asset accounts in the Air Force accounting system.

- Recommendation No. 17: The GAO recommended that the Secretary of the Air Force direct the Chief Financial Officer to report actual and planned cost data to the Congress so better decisions can be made on program funding.

  DoD Response: Concur. All data required by the Congress will be provided. As noted in response to Recommendation 16, however, applicable data from sources other than the Air Force asset accounts are being used to provide the Congress with required data.

- Recommendation No. 18: The GAO recommended that the Secretary of the Air Force direct the Chief Financial Officer to account and report on satellites through either revisions to existing systems or a new system to provide oversight of these assets.

  DoD Response: Concur. The Department is taking steps, as part of the Defense Management Report initiatives, to develop a DoD-wide standard accounting module to record the cost of Government property.

- Recommendation No. 19: The GAO recommended that the Secretary of the Air Force direct the Chief Financial Officer to establish and implement procedures to identify and record in the accounting records equipment paid for and accepted by the Air Force but held by contractors.

  DoD Response: Concur. The Department is taking steps, as part of the Defense Management Report, to correct this Air

Force deficiency. One of the Department's initiatives involves developing a DoD-wide standard accounting module to record the cost of Government property in the hands of DoD contractors.

- Recommendation No. 20: The GAO recommended that the Secretary of the Air Force require the Chief Financial Officer to establish a policy to value unserviceable items to reflect the estimated costs of repair.

See comment 5

DoD Response: Partially Concur. As a part of the Defense Management Report initiatives, a revised policy will be considered.

- Recommendation No. 21: GAO recommended that the Secretary of the Air Force require the Chief Financial Officer to adopt an improved standard cost accounting system integrated with the general ledger which provides for accurate determination of standard costs based on replacement costs, identification of inflation growth, and variance analysis with respect to purchase prices, material usage, and repair costs.

See comment 5

DoD Response: Partially Concur. A Defense Management Report initiative to develop a standard financial management requirements is expected to meet the Department's needs in this area.

- Recommendation No. 22: The GAO recommended that the Secretary of the Air Force direct the Chief Financial Officer to initiate a special effort to deal with the root causes and reduce the $18 billion of inventory in excess of strategic requirements.

See comment 6

DoD Response: Partially Concur. The Department does not agree that the $18 billion referred to by the GAO is excess to strategic requirements. The Department has recognized that the large value of inventories requires appropriate action. The DoD acquisition officials have initiated actions to improve inventory management through the Defense Management Report initiatives.

- Recommendation No. 23: The GAO recommended that the Secretary of the Air Force make improving accounting practices and systems an Air Force-wide priority effort, supported by adequate resources.

DoD Response: Concur. The Defense Management Report initiatives have been established to develop standard DoD-wide functional requirements for accounting practices and systems. This effort enjoys a high DoD priority.

- Recommendation No. 24: The GAO recommended that the Secretary of the Air Force direct the Chief Financial Officer to develop

a comprehensive plan for improving and integrating the Air Force's financial management and accounting systems.

DoD Response: Concur. A Defense Management Report initiative is expected to provide for such improvement and integration.

- Recommendation No. 15: The GAO recommended that the Secretary of the Air Force review the systems requirements of Base Level Accounting and Report System and all related systems to ensure that they are complete and that they address all the Air Force's concerns about its operations and the problems addressed in this report.

DoD Response: Concur. A Defense Management Report initiative provides for DoD-wide accounting functional requirements and systems. This initiative, which would alleviate the need for the Air Force to pursue development of the Base Level Accounting and Reporting System, can be expected to address the conditions identified in this draft report.

- Recommendation No. 16: The GAO recommended that the Secretary of the Air Force ensure that a project management structure and plan are in place to avoid the potential pitfalls that have caused problems in past systems development efforts. This structure must include adequate representation and participation by top management and functional users in all phases of the development effort.

DoD Response: Concur. A Defense Management Report initiative, to develop standard DoD-wide requirements and systems is being established. This effort, which is fully supported by the Secretary of Defense, will have both "top management" and "functional user" involvement, including adequate structure, plan, and personnel and financial resources.

The following are GAO's comments on the Department of Defense's letter dated February 21, 1990.

GAO Comments

1. The title of the final version of our report is Financial Audit: Air Force Does Not Effectively Account for Billions of Dollars of Resources.

2. We have modified the report to specifically discuss the Selected Acquisition Reports sent to the Congress and recognize that the costs they report are more accurate than the costs provided by the Air Force's financial management systems.

3. The Defense Management Report is addressed under Agency Comments at the end of the executive summary.

4. The DOD response is discussed under Agency Comments and Our Evaluation at the end of chapter 2.

5. The DOD response is discussed under Agency Comments and Our Evaluation at the end of chapter 5.

6. We corrected the report to show $10 billion as unrequired inventory.

SECRETARY OF THE AIR FORCE
WASHINGTON

February 15, 1990

Honorable Charles A. Bowsher
Comptroller General of the United States
Washington, D.C. 20548-0001

Dear Chuck:

You asked that I review personally the GAO draft report on the Air Force's FY 88 trial financial statements. Having done so, I have to tell you that we have very serious disagreements with both the content of the draft report and the GAO's handling of the "audit."

The GAO findings are fundamentally misdirected. They compare Air Force financial systems to GAO pre-conceived accounting statement requirements that have not been promulgated for executive branch adoption by the OMB. The GAO apparently wants government agencies to have the same auditable balance sheets and other financial statements as for-profit companies. This concept has not been accepted by the Congress or the Executive Branch.

The draft report is deficient in many other respects. It makes frequent assertions about the benefits from financial statements that meet the GAO-self-initiated standard, but presents no evidence to back them up. No cost savings are identified. Implementation costs, likely to be in the billions for the DOD, are ignored.

Overall, the draft report offers a narrow CPA's view of the information needed for defense decisionmaking that has limited relationship to the real problems of defense management. Many available sources of information supporting defense decisionmaking are ignored. There is no mention of the Defense Planning, Programming and Budgeting System, the Selected Acquisition Reports, the Independent Cost Analysis process, or the many analytical studies of cost and other factors. The report simply does not make a case why I need to know the depreciated, cost-based dollar value of the B-1B inventory in order to make an informed decision about the need for the B-2. Even if that information were useful, why do I need it at a penny-wise level of accuracy that a CPA would judge "auditable"?

The GAO's handling of this "audit" raises further troubling issues. The Air Force financial management community, widely recognized as leaders in the government, volunteered to work with the GAO and develop trial financial statements to provide a test case for GAO's ideas. In return, the GAO writes a hypercritical

and inflammatory report. (At a public meeting, GAO staff have described intentionally sensationalizing the title of the report to increase its newsmaking potential.) I would point out that the GAO will need the cooperation of the financial management professionals to carry out improvements to executive branch systems. This "audit" is a textbook case of how not to secure such cooperation.

The GAO's own procedures were not followed either. This is a summary report, but we are asked to comment without having the four underlying reports available. We were given 14 days instead of the normal 30 days to respond, and were denied a formal exit interview.

While pushing the GAO agenda, the report offers little recognition of the Air Force fund control system. The draft report mentions that our systems emphasize fund control (making sure spending limits are not exceeded); with some exceptions, fund control is adequate and expenditures did not exceed appropriations. Since the stewardship of appropriations for which we have been entrusted is one of our highest priorities and major financial responsibilities, we would have thought the Air Force's overall performance in this regard would have warranted some positive recognition.

Air Force self-reports have identified the shortcomings in its financial systems. The major system deficiencies discussed in the GAO report (lack of a transaction-based general ledger and financial control of government-furnished material in the possession of contractors) have been fully explained in our reports under the Federal Manager's Financial Integrity Act, and corrective actions are underway. The Air Force is fully committed to its goal of a financial management system that meets Office of Management and Budget objectives and complies with existing Comptroller General standards. As evidence of this commitment, the Air Force is currently planning to spend over $200 million over the next five years on financial system improvements and enhancements.

While GAO feels that "more needs to be done," these needs must be balanced and compete with other pressing requirements of the Department. Additionally, we must comply with OMB Circular A-127 requirements to gather and process financial management data only when necessary to meet specific internal management needs or external requirements, to tailor reports to specific user needs, and terminate reports if usage does not justify costs. The draft report fails to acknowledge the numerous decision-support tools available to Air Force leadership which supplement, but are outside the accounting and finance system.

The DOD Inspector General reviewed the draft GAO report for the Secretary of Defense and cited many of these same concerns:

"In addition to our general concern that the overall tenor of this report is unfair and fails to take proper note of existing management systems, without any specific support whatsoever, the GAO assumes that better financial systems will automatically lead to better decisions on the selection of future weapon systems. The GAO also ignores the enormous cost of developing these systems. For example, the costs for just one such system currently in development, the Army Reserve Component Automation System, has grown from $250 million to over $1.5 billion.

The GAO report offers no specific savings, but nonetheless infers from its title that "billions" can be saved. In our view, capitalization and depreciation of military hardware is of questionable value. Industrial and stock funds are "fed" by appropriations, which expire annually. "Losses" to one specific part of a stock fund are "gains" to an appropriation level account. The cost of making these stock and industrial funds more accurate at the lowest levels will probably exceed the utility of the more accurate information to DOD decisionmakers. Finally, the GAO comments with respect to long supply items and loss of inventory control (a very serious problem both within our own depots and for material in the hands of DoD contractors) have little or nothing to do with financial reporting, since these stocks must be managed on an item/inventory basis for readiness and warfighting purposes--not on the basis of a financial statement."

To sum up, this draft report creates the misimpression that the Air Force is wasting and mismanaging billions of the taxpayers' dollars because of inaccurate and unreliable financial data. Promulgating such a misperception would be an extreme disservice to the public and to the Air Force because it is simply without foundation. I urge you to send your team back to the drawing board with instructions to prepare a report that fairly evaluates the pros and cons of GAO's approach and which uses Air Force data only as a test case for a new approach, while recognizing that Air Force systems comply effectively with existing requirements.

I'm sure if we were to work together in a spirit of open evaluation, we could bring about the improvements in defense management to which we are all committed.

Sincerely,

Don

Donald B. Rice